



GOVERNOR'S  
**BUDGET**  
**HIGHLIGHTS**

2004-05



Arnold Schwarzenegger, Governor  
State of California

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# ECONOMIC RECOVERY— A WORKOUT PLAN FOR THE STATE'S BUDGET

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## California's Fiscal Challenge

Prior to taking office, the first phase of Governor Schwarzenegger's independent audit of state government finances was released, detailing the size and scope of the fiscal crisis that the Governor and the Legislature must now confront.

Among the key findings of the first phase of the audit were as follows:

- While revenues have increased by 25 percent over the past five years, State expenditures have risen by 43 percent. If government had simply spent at the same rate that California's economy has grown, the State's budget would be balanced today.
- If state government had not spent the extraordinary tax revenues from the one-time surge in capital gains and stock options on ongoing programs, the State budget would not be in the crisis it is in today.
- If, over the past five years, the previous Administration and the Legislature had not created or expanded programs that the State could not afford—expenditures in the Budget would be lower than they are today. In health and human services alone, significant program expansions have totaled \$1.3 billion.
- Over the past five years, State bureaucracy has grown and agencies have been allowed to consistently spend above and beyond their budgeted levels.



As a result, by the time Governor Schwarzenegger took office, the State of California had accumulated an inherited debt of more than \$22 billion, representing policy and budgetary decisions made by the Legislature and the prior Administration. In the absence of corrective actions to change these policies, the State will continue incurring operating deficits, estimated at \$14 billion in fiscal year 2004-05.

In addition, all three major credit rating agencies have lowered the State's credit rating this year. California's General Obligation Bond rating is "Triple B," which is barely above investment grade and is currently the lowest among all the states. Anything below "Triple B" is commonly known as a junk bond.

### **Total Inherited Debt**

Accumulated Deficit Through 2002-03 <sup>1/</sup>	\$ 9.3 billion
Operating Deficit in 2003-04 <sup>1/</sup>	<u>3.0 billion</u>
Total Accumulated Deficit <sup>1/</sup>	\$12.3 billion
Effect of Prior Decisions After 2003-04	<u>9.8 billion</u>
Total Inherited Debt	\$22.1 billion

<sup>1/</sup> In November, the audit projected accumulated deficit through 2002-03 at \$10.6 billion, operating deficit in 2003-04 at \$4.3 billion, and total accumulated deficit at \$14.9 billion. Since then, natural revenue growth and expenditure decreases have exceeded expectations.

California also faces a potential cash crisis this year. In order for the State to meet its daily cash-flow needs, the previous Administration borrowed a total of \$14 billion using short-term notes. Those notes are due to be repaid in June 2004.

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## **California Recovery Plan**

Faced with such massive and growing debt, the Governor is proposing a four-part economic recovery plan, which consists of the following:

- The Economic Recovery Bond Act to refinance a portion of the inherited debt.
- A budget for 2004-05 that moves toward structural balance.
- A Constitutional amendment to require balanced budgets with prudent reserves in the future.
- Improving the business and jobs climate in order to revitalize the State's economy and improve revenue growth over time.

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### **Economic Recovery Bond Act**

The California Economic Recovery Bond Act (Chapter 2, Statutes of 2003, Fifth Extraordinary Session [AB 9]) authorizes, subject to California voter approval at the March 2, 2004, statewide primary election, the issuance of up to \$15 billion in bonds to finance the negative General Fund reserve balance as of June 30, 2004, and other General Fund obligations undertaken prior to June 30, 2004. This measure provides that the bonds authorized under the Act may be used to retire any Fiscal Recovery Bonds issued under the provisions of Chapter 13, Statutes of 2003, First Extraordinary Session (AB 7). Under the Act, the State will not be permitted to use more than \$15 billion of net proceeds of any bonds issued to address the inherited debt. The bond authorization will replace the currently authorized Fiscal Recovery Bonds. This Act will only become operative if the voters approve this Act and the Balanced Budget Amendment, Chapter 1, Statutes of 2003, Fifth Extraordinary Session (ACA 5) at the March 2004 election.

The repayment of the bond will be secured by a pledge of revenues from an increase in the State's share of the sales and use tax of one-quarter cent starting July 1, 2004, which will be deposited into the Fiscal Recovery Fund. Local governments' share of the sales and use tax will be decreased by a commensurate amount. Beginning in 2004-05, local governments' share of local property tax



revenues will be increased by an amount equal to the one-quarter cent reduction in the local sales and use tax. The new sales and use tax rates will automatically revert to current levels as soon as the bond is repaid. The repayment of the bond may be accelerated with transfers from the Budget Stabilization Fund, as specified in the Balanced Budget Amendment. In the event the dedicated revenue falls short, the State also would pledge its full faith and credit by using General Fund revenues to repay the debt service.

The Administration expects the voters to approve the bond at the March 2004 election. However, to be fiscally prudent, the Administration continues to pursue judicial validation and to take all necessary administrative steps to prepare for the sale of the Fiscal Recovery Bonds, as authorized by current law. A final decision on the Fiscal Recovery Bonds will be made after the March 2004 election.

**Use of Bond Proceeds**—The Administration intends to use the bond proceeds to refinance a portion of the \$22 billion inherited debt. It plans to sell bonds sufficient to provide for net proceeds of \$12.3 billion for the following:

- \$9.242 billion to pay for the accumulated budget deficit through 2002-03.
- \$1.881 billion to pay for the State's costs of employee retirement contributions in 2003-04. The 2003 Budget Act assumed these costs would be paid from the proceeds of pension obligation bonds; however, the bond sale has been delayed by court order.
- \$188 million in loan repayments to various special funds in 2003-04 and 2004-05.
- \$325 million revenue loss in 2004-05 from the prior year due to changes in the use of Net Operating Losses pursuant to the 2002 Budget Act.
- \$100 million in increased general obligation debt service in 2004-05 due to the State Treasurer's bond restructuring plan.



- \$209 million in increased employee compensation in 2004-05 related to 16 bargaining units delaying a 5 percent bargained pay raise in 2003-04.
- Approximately \$300 million contribution to the \$635 million General Fund reserve in 2004-05.

Depending on the economic environment, the Administration may elect to sell the remaining amount of bonds in 2005-06 to refinance part of the deferred obligations that will become due in 2005-06 (total due in 2005-06 will be \$2.3 billion).

**Deficit Recovery Fund**—In 2003-04, a new fund will be created for the purpose of deficit recovery. The amount of bond proceeds received but not needed to address the accumulated budget deficit through 2002-03 will be transferred into this fund. The moneys in this new fund will be used in 2004-05 to pay for deferred obligations due in 2003-04 and 2004-05 as outlined above. While the Administration expects the bonds will be sold within the current year, this portion of the bond proceeds must be set aside to allow for a gradual transition to a balanced budget by using the new fund to cover what would otherwise be the General Fund's costs of the inherited debt.

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### A Budget That Moves Toward Structural Balance

In the absence of policy changes, the State would face a deficit of over \$26 billion, consisting of a \$9.2 billion year-end deficit in 2002-03, an additional shortfall of \$3 billion in 2003-04, and a shortfall of \$14 billion in 2004-05.

In December 2003, the Administration proposed reductions totaling \$3.9 billion (\$2.3 billion in 2003-04 and \$1.6 billion in 2004-05). To close the remaining budget gap, additional budget solutions are included in the proposed budget: \$0.3 billion in 2003-04 and \$12.8 billion in 2004-05 offset by a reduction of \$0.8 billion in 2002-03. Overall solutions proposed exceed the projected budget gap by \$635 million (the amount of the reserve).

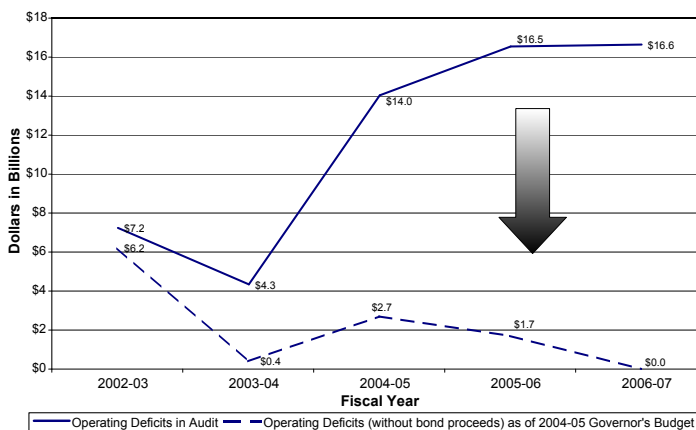
It should be noted that the solutions include the use of a portion of the bond proceeds to create a Deficit Recovery Fund. This allows the State to move in a graduated fashion toward structural budget balance. A combination of factors will close the remainder



of the structural gap in 2005-06 and 2006-07. First, an estimated \$1.7 billion will remain from the bond to help smooth the transition after 2004-05. Second, many of the reforms contained in the Budget will produce savings that increase dramatically in subsequent years. The Governor is taking a long-term reform approach to government spending, rather than reacting to short-term budget exigencies. And third, it is of supreme importance that the Administration and Legislature enact reforms to improve the business and jobs climate, which in turn should accelerate growth in the State's economy and General Fund revenues.

As the following chart shows, the Governor's measured, long-term approach puts the State on the path to close the operating deficits identified in the audit.

**Closing the Operating Deficit**



## Balanced Budget Requirement, Special Reserve Fund

As part of the Governor's commitment to bring California back to a sound economic foundation, this constitutional amendment (Chapter 1, Statutes of 2003, Fifth Extraordinary Session, ACA 5) will be submitted to the voters on the March 2, 2004, ballot. The proposed amendment will ensure that the State enacts budgets that keep expenditures within available resources. It would also require the State to contribute to a special reserve of 1 percent

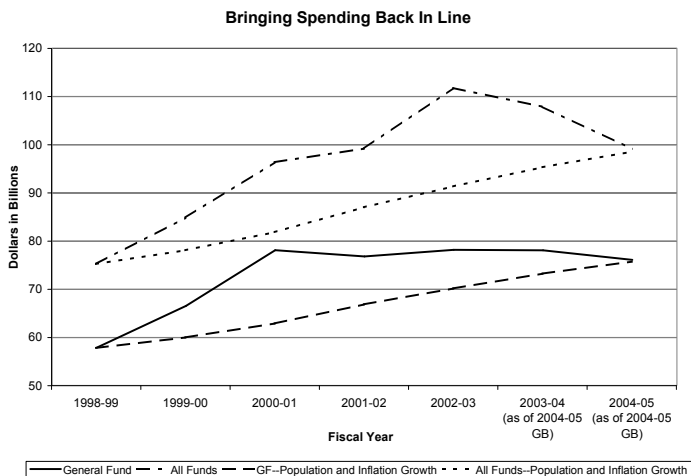
of revenues in 2006-07, 2 percent in 2007-08, and 3 percent in subsequent years. This special reserve will be used to repay the Economic Recovery Bonds and provide a rainy day fund for future economic downturns or natural disasters. It would allow the Governor to declare a fiscal emergency whenever he or she determines that General Fund revenues will decline below budgeted expenditures, or expenditures will increase substantially above available resources. Finally, it would require the Legislature to take action on legislation proposed by the Governor to address fiscal emergencies.

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### **California's Competitiveness**

While California's economic indicators suggest that modest reform is projected for 2004, job growth throughout the state will be tempered due to the high cost of doing business in California. Some estimates conclude that business costs are 30 percent higher in California than in other western states—most note the highest workers' compensation rates in the nation as one of the largest components of the high cost. The workers' compensation system has ballooned from \$11 billion to \$28 billion in just five years—resulting in 200 percent to 300 percent premium increases for many of the state's employers.

Governor Schwarzenegger's plan for California's Recovery is based on improving the state's business climate to bring jobs back to California. In order to improve the job-generating environment, his plan includes a comprehensive overhaul of the workers' compensation system. In addition, the Governor is harnessing the existing economic development and promotion entities in state government and plans to market California as a desirable place to establish and grow businesses. California's fiscal health is inextricably linked to the state's economic prosperity. Governor Schwarzenegger is committed to increasing economic vitality and promoting the creation of well paying jobs.



■ As the statewide chart here shows, the 2004-05 Governor's Budget will bring General Fund spending back in line with the population growth and inflation.

# ECONOMIC OUTLOOK

FIGURE ECON-1

## Key Economic Indicators

(Annual Percent Change, except for New Housing)

	2003	Forecast	
		2004	2005
U.S. Gross Domestic Product, adjusted for inflation	2.9 %	4.2 %	3.6 %
California Nonfarm Employment	-0.2 %	1.1 %	2.1 %
California Personal Income	3.8 %	5.6 %	5.9 %
California Consumer Price Index	2.4 %	1.9 %	2.7 %
California New Housing Units	194,000	192,000	198,000

The national and California economies strengthened in the second half of 2003. Increased business investment and job growth—the two missing pieces of a sustainable, stronger economic recovery—appeared to be in place as year-end neared. Improved labor markets and stronger output growth are expected for both economies in 2004 and 2005.

## The Nation

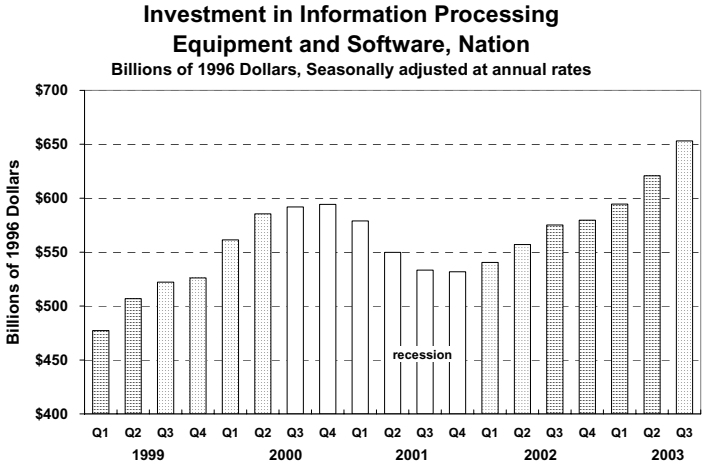
- National economic output expanded at its quickest rate in nearly 20 years in the third quarter. Even better, the gain was broad-based across spending categories. Tax refunds and tax rate cuts spurred consumers to boost their spending. Businesses invested considerably more in equipment and



software. Residential construction posted a big gain. Even net exports added to the economy's growth.

- Gross private domestic investment grew by over 18 percent at a seasonally adjusted, annual rate in the third quarter. Within this category, nonresidential fixed investment expanded by 14 percent and residential investment, by 23 percent. Spending on information processing equipment and software surged by 23 percent. All of this was particularly encouraging because the primary cause of the economy's sluggishness earlier in the recovery was weak business investment.
- Growth should accelerate to 4.2 percent in 2004. After cooling in the fourth quarter of 2003, consumer spending will pick up in 2004, fueled by bigger employment gains and larger than normal tax refunds. The stronger economic climate and the temporary tax incentives for investment in equipment and some software introduced in the May 2003 tax package will boost investment spending further in 2004. Nonfarm payroll employment will grow by about 150,000 jobs per month in the first two quarters of 2004 before accelerating to about 250,000 per month for the remainder of the year. This is somewhat slow by historical standards.
- Tight energy supplies pose a risk to the outlook. Worldwide oil production is currently close to capacity, and the gap between supply and demand in the North American natural gas market is very thin. A disturbance to oil output or unusually cold weather in North America this winter could cause energy prices to soar just as world growth is set to accelerate in 2004.

FIGURE ECON-2



## California

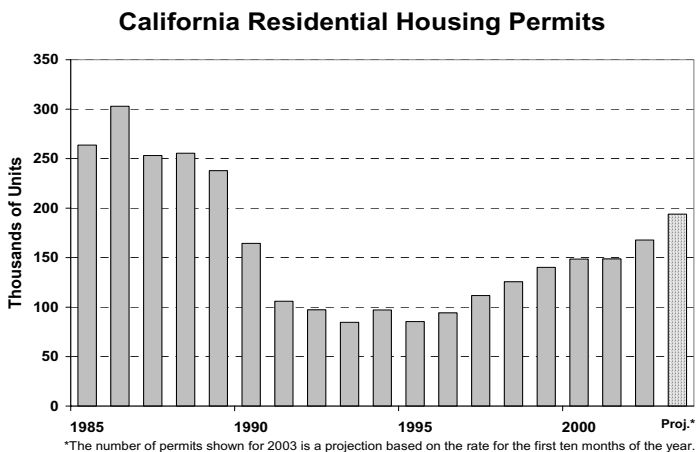
- The recovery of the California economy broadened and strengthened in 2003. California personal income increased for the sixth consecutive quarter in the second quarter of 2003. Also encouraging, exports of made-in-California merchandise began to increase again in the third quarter after falling for nearly three years, and taxable sales posted a fifth consecutive year-over-year gain. In addition, manufacturing activity expanded in the third quarter in the Inland Empire and Orange County according to local surveys of purchasing managers. But California labor markets were not as strong as those in the rest of the nation, on average, near year-end.
- California's tourism industry continued to improve while remaining below pre-September 11 levels. The "drive-to" market did best, convention business improved, but business travel remained weak. Residential construction and real estate remained strong. Through October, home permits were on a pace to hit 194,000 units for the year, about a 16 percent gain over 2002 and the highest level since 1989. In the first ten months of 2003, sales of existing, detached single-family homes were up 3.5 percent from a year earlier, and the



percentage increase in the median price of these homes was in the mid-teens. Commercial real estate building and markets did not fare as well; building was down and markets were just slightly improved.

- The outlook for the California economy is for moderate growth in 2004 and even better growth in 2005. Unemployment will likely remain above 6 percent throughout the period. Personal income will grow by about 5.6 percent in 2004 and almost 6 percent in 2005—good, but not as quickly as in past recoveries. Low interest rates and a considerable amount of federal fiscal stimulus will boost the state economy in 2004. Cuts in expenditures to reduce the state government budget deficit will be a drag on the state economy, however.
- Consumers are the linchpins of the outlook. They have to continue to be optimistic that stronger labor markets lie just ahead.

FIGURE ECON-3





# REVENUE ESTIMATES

The long-anticipated recovery of California revenues arrived in 2003 and the outlook for 2004 and 2005 is for continued, though moderate, growth. Therefore, the revenue outlook has improved from what was expected at the time the 2003 May Revision was prepared. Since enactment of the 2003 Budget Act, the General Fund revenue forecast for major taxes and licenses has increased by \$1.7 billion for the past and current years combined. In addition, an increase of 4 percent in revenues, or \$2.9 billion, to \$76.4 billion is expected for 2004-05. The revenue increase includes significant gains in the three major taxes: personal income tax, sales tax, and corporation tax.

Improvement in the California economy began late in 2002, with taxable sales showing year-over-year growth beginning in the third quarter of 2002, after four consecutive quarters of negative growth. During 2003, personal income tax withholding also began to show year-over-year growth, after declining nearly every month since mid-2001. Finally, personal income tax estimated payments are expected to recover in 2004, after three years of negative growth.

As has been noted for some time, the State's remarkable revenue growth in the late 1990s was driven by stock market related gains, while the fall-off from 2000 through 2002 largely reflected the market's decline. With regard to market-related income, growth is expected to resume in 2003 and should continue, albeit at more sustainable levels.

Despite the positive developments in the economic and revenue outlook, revenue growth alone will not solve the State's budget problems. Because of the accumulated deficit and the structural



deficit, the Governor's Budget includes major program reductions and restructuring, as described in other sections.

## Major Revenue Sources

Personal income tax revenues are projected to be \$35.1 billion in 2003-04 and \$38 billion in 2004-05. Capital gains peaked in 2000 before plunging 57 percent in 2001 and an additional 30 percent in 2002, based on preliminary data. This forecast assumes that the revenue bubble that burst in 2001-02 and 2002-03 is now completely deflated and moderate growth will resume in 2003-04.

Sales and use tax revenue is forecast at \$23.7 billion in 2003-04 and \$25 billion in 2004-05. Taxable sales for 2003 are expected to be up by 2.3 percent compared to 2002. Taxable sales are anticipated to grow at a faster rate in 2004 and 2005 due to the improving economy, increasing by 5.8 percent and 5.4 percent, respectively.

Corporation tax revenues are expected to total \$7.5 billion in 2003-04 and \$7.6 billion in 2004-05. Taxable profits are estimated to increase by 6.7 percent in 2003-04 and 13.2 percent in 2004-05.

The Governor's Budget revenue forecast also reflects the following proposals:

- **Personal Income Tax Integrated Nonfiler Compliance (INC) Program**—The Budget proposes to identify additional taxpayers who do not file tax returns, but owe personal income tax. The proposal is estimated to increase revenues by \$12 million in 2004-05, and \$43 million in 2005-06.
- **Sales Tax on Gasoline**—The sales tax on gasoline and diesel sales is allocated for transportation purposes. A portion of the sales tax on gasoline (and diesel sales) is allocated to the Public Transportation Account (PTA). When gasoline prices are high relative to other sales, the PTA receives the "spillover" sales tax revenues. The Budget proposes to maintain the base level of transfers to the PTA, but specifies that any excess sales tax revenue on gasoline remains in the General Fund, thereby increasing General Fund revenues by \$17.5 million

in 2003-04, above the \$87.5 million expected at the 2003 Budget Act. This is a mid-year spending reduction proposal.

- **Natural Heritage Preservation Tax Credit**—The Budget proposes to suspend the award of credits for two years, 2003-04 and 2004-05, for a General Fund revenue savings of \$8.7 million in 2003-04 and \$10.3 million in 2004-05. This is a mid-year spending reduction proposal.
- **Indian Gaming Revenues**—It is the intent of the Administration to renegotiate tribal gaming compacts with California's 64 tribes that have gaming compacts, and to negotiate new compacts with any additional tribes that wish to commence class III gaming. Part of any such renegotiation will include demands by the State that tribes currently gaming, or those wishing to game, pay a significant share of revenues to the State. Current estimates of annual income to California tribes as a result of gaming operations range between \$3 billion and \$5 billion. The Administration has announced a target State share of such revenues to be 25 percent on an annual basis. While it is uncertain that the Administration will actually receive the State's target revenue percentage as a result of negotiations during calendar year 2004, there clearly will be improved revenue streams to the State from tribal gaming operations during 2004-05. Given that the full State share of 25 percent of tribal revenues may take some time to achieve, the Budget projects \$500 million in additional revenue to the State from tribal gaming operations in 2004-05.

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# K-12 EDUCATION— PROPOSITION 98

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## Overview

From 1999-00 through 2003-04, over \$2.7 billion was added to the Proposition 98 funding level above what was required by the Constitution. It is clear that part of the structural budget problem the State now faces is due to this increase in education spending beyond what the State could afford without cutting other programs.

Recognizing the importance to the State of maintaining the level of support for our schools, the Administration chooses not to reduce funding for K-14 education. The formula for the Proposition 98 funding level would require an increase in K-14 funding of \$3 billion in 2004-05.

The Governor's Budget proposes that schools and community colleges receive a \$1 billion increase in property taxes allocated to schools, but that no State funding be added this year. This will allow normal K-12 funding adjustments for both growth in numbers of students and cost-of-living to be made. Additional program funding capacity of about \$700 million is available within the existing funding level due to the expiration of programs and adjusting for one-time costs incurred during 2003-04.

**Rebasing Proposition 98**—Proposition 98 allows a temporary rebasing of the required appropriations if a bill is enacted with a two-thirds vote of the Legislature. The Governor's Budget proposes that the level of Proposition 98 appropriations be rebased at a level approximately \$2 billion less than would otherwise be required for 2004-05.



**Agreements to Restore Funding**—This action will create an additional amount of \$2 billion of what is called a “maintenance factor” that is required to be restored to the Proposition 98 budget in future years. Based on current projections of future revenue growth and other economic factors, the additional maintenance factor could be restored to the guarantee over the following three years, with substantial growth averaging about \$750 million per year as the economy expands. Thus we project that this rebasing of the guarantee will impact school funding for only four years. These funding additions will be in addition to the normal guarantee adjustments for student enrollment and per capita personal income. The Administration agrees to make general purpose funding a priority for 2004-05 and following years in the use of the maintenance factor funding.

**Retiring Old Debts**—Additionally, appropriations estimated to be required for prior years above the current level of the budgets for those years are proposed to be deferred and included in a settle-up agreement with the education community to be implemented in a series of statutory appropriations beginning in 2006-07. This agreement will retire the outstanding debts to the schools from 1995-96 and 1996-97 of \$250.8 million and the additional amounts estimated to be needed to meet the guarantee for 2002-03 and 2003-04 of \$517.9 million and \$444.9 million, respectively. Funds appropriated for settle-up will be designated for one-time expenses such as instructional materials, training, and deferred maintenance.

## Proposition 98 (Dollars in Thousands)

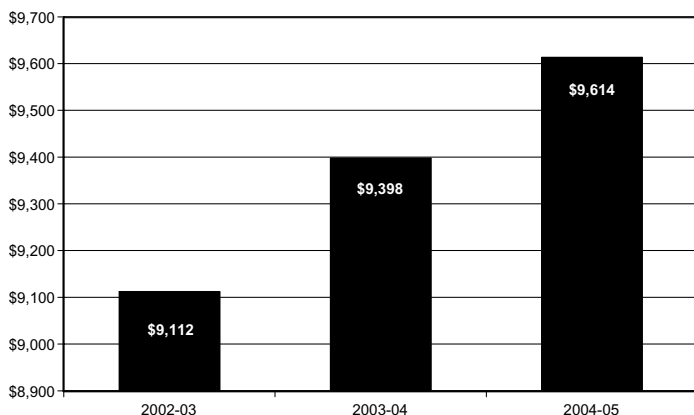
<b>Appropriations</b>	<b>2002-03</b>	<b>2003-04</b>	<b>2004-05</b>
K-12 Education	\$39,000,798	\$41,585,944	\$42,034,848
Community Colleges	4,623,085	4,358,857	4,678,804
<b>Total</b>	<b>\$43,623,883</b>	<b>\$45,944,801</b>	<b>\$46,713,652</b>
<i>State General Fund</i>	<i>28,842,957</i>	<i>30,166,130</i>	<i>29,739,800</i>
<i>Local Revenue</i>	<i>14,780,926</i>	<i>15,778,671</i>	<i>16,973,852</i>

Due to an increase in General Fund revenues, the 2002-03 and 2003-04 Proposition 98 minimum guarantees increased since enactment of the 2003 Budget Act creating settle-up obligations not reflected in the totals above.

- Total 2004-05 K-12 funding from all sources is now \$58.1 billion, a \$1.9 billion increase from 2003-04 and a \$4.2 billion increase over the 2002-03 level.
- Total 2004-05 per-pupil expenditures from all sources are \$9,614, up \$216 from 2003-04 and up \$502 from the 2002-03 level.
- Total Proposition 98 support for K-12 education will increase by over \$451 million in 2004-05, to \$41.9 billion.
- Proposition 98 per-pupil spending for the budget year will increase to \$6,945, which is \$5 over the 2003-04 level and \$357 over the 2002-03 level.



### K-12 Education Spending Per Pupil



## K-12 Spending Changes

**K-12 Enrollment Growth**—The Governor's Budget provides a \$406 million increase to fully fund statutory average daily attendance growth (\$280 million revenue limits, \$37 million special education, and \$89 million other categorical programs).

**Public Employees Retirement System (PERS)**—The Budget fully funds an estimated \$106 million increase in the PERS school employer contribution rate. Failure to fund this increase would effectively reduce existing budgets for school districts and county offices of education.

**Unemployment Insurance (UI)**—The Budget fully funds an estimated \$136 million increase in local education agency UI. This increase is attributable to a more than doubling of the UI rate, due to increased benefit amounts and longer eligibility periods, coupled with local staffing reductions.

**Cost of Living Adjustment (COLA)**—The Governor's Budget fully funds an estimated \$740 million 1.84 percent statutory COLA increase (\$555 million for revenue limits, \$70 million for Special Education, and \$115 million for various categorical programs).



**Equalization**—The Budget provides nearly \$110 million for school district revenue limit equalization to address the disparity in base general-purpose funding levels. This equalization adjustment will apply to current revenue limits, as adjusted for excused absences, that are in place prior to the proposed shift of categorical funding.

**Deferred Maintenance**—The Budget includes \$250.3 million General Fund, an increase of \$173.3 million, for the State Deferred Maintenance Program to fully fund the statutory one-half of one percent State match.

**Instructional Materials**—While \$175 million in Instructional Materials funding is proposed for transfer to revenue limits in a categorical funding shift, the Budget provides an additional \$188 million to fund K-12 standards-aligned instructional materials adoptions for the core subject areas: Mathematics, English Language Arts, History-Social Science, and Sciences.

**Internet2**—The Budget provides funding of \$21 million to county offices of education to maintain high-speed Internet2 connectivity and network infrastructure.

**Local Revenue**—The Budget estimates growth in local property taxes of 8.5 percent. In addition, there were two significant adjustments to Educational Revenue Augmentation Fund distributions that affect school property taxes:

- A shift of approximately \$1.25 billion from K-12 schools and community colleges to local governments to compensate for the 0.25 percent reduction in the Bradley-Burns local sales tax that is used to pay for the State's deficit reductions bonds.
- A shift of \$1.34 billion from local governments to K-12 schools and community colleges. The Budget proposes this mechanism to continue the level of reduction in local government revenues due to the lag time involved in implementing the increased payments to local governments that offset vehicle license fee reductions in 2003-04.

## K-12 Education Reforms

**Categorical Funding Reforms**—Shifting \$2 billion from 22 specified categorical programs to the general purpose apportionments of the districts and county offices currently receiving those



categorical funds will provide a significant increase in flexible funding. Local education agencies can continue to provide existing programs, or shift funds to local innovative programs and direct funding to the most critical needs. It is expected that priority will be given to meeting existing commitments and restoring school district budgets to balance. Districts are required to provide opportunities for community members, parents, teachers, and principals to participate in decision-making about these shifted funds. This funding change is conditioned upon increased accountability for academic and fiscal performance described below.

**Charter Schools**—The Governor's Budget shifts charter school categorical block grant funds to charter school general-purpose entitlements (\$21.9 million) and to the Economic Impact Aid program (\$14.5 million), with a distinct charter school allocation. To mirror the per-student funding for programs in the charter categorical block grant that are shifted to general purpose funding for districts, an increase of \$24.5 million in total funding is provided to charters in addition to the shifted funds.

**School District Academic Accountability**—The Administration proposes to fill a gap in the State's accountability system by creating a set of district academic performance targets for school districts. The State does not currently have a district level accountability system, and although the federal No Child Left Behind Act includes such a system, it does not differentiate well between failing and improving districts and does not focus on the lowest-performing districts. The accountability system proposed by the Administration would allow the State to identify the lowest performing districts so that interventions may be applied to improve performance.

**Child Care Reform**—According to a report released by the State and Consumer Services Agency in 2001, California has the most generous eligibility, subsidy, and co-payment policies of any other large state. However, despite California's fiscal situation, the Budget maintains approximately \$3 billion for child care programs administered by the State Department of Education (SDE) and Department of Social Services (DSS). This reflects the Administration's view that children are a priority investment and that families should be supported in their work participation and personal responsibility efforts.

In addition to caseload changes, statutory growth and cost-of-living adjustments, and the backfill of one-time funds used in prior fiscal years, funding for child care programs reflects an estimated \$164.8 million in savings from reforms. These reforms will ensure access for the neediest families, establish a more equitable and cost-effective system through reasonable fees and provider reimbursement limits, assist low-income families in achieving independence from subsidies, and ensure that children continue to be protected. Specific reforms include the following:

- Lowering the income threshold at which families are asked to share in the cost of child care, with gradual fee increases as family incomes rise, with a cap of 10 percent of income consistent with federal guidelines.
- Having providers directly responsible for collecting fees from subsidized families, as they currently do for their private-pay clients.
- Limiting subsidies for older children who have access to before and after-school programs.
- Reforming market-based reimbursement rate limits to provide financial incentives for higher quality care, including obtaining licenses, integrating early childhood development education principles, receiving health and safety training, and becoming accredited.
- Reforming income eligibility by implementing a tiered income eligibility structure that recognizes differential costs of housing in appropriate counties.
- Ensuring that CalWORKs families who are not able to obtain a slot in the general child care system can continue to receive child care subsidies while they remain on cash aid, and for three years thereafter.
- Authorizing CalWORKs families to enter waiting lists for non-time limited general child care programs as soon as they begin earning income.
- Standardizing the length of time a family can access subsidies while pursuing education and training.



- Reforming the referral duration period and fee policy for referrals of “at risk” children.

**Child Care Fraud and Compliance**—Information from counties that actively investigate child care fraud indicates that the range of fraud may range from 30 percent to 40 percent in alternative payment programs that administer monthly payments to providers selected by families participating in voucher programs. Even a 10 percent rate of fraud may cost the State well over \$100 million annually. These funds could be redirected to provide child care services to truly needy families, or to reduce program costs.

The Budget proposes a \$2 million augmentation from one-time federal funds for administrative start-up costs for a comprehensive anti-fraud proposal that is under development by the Administration. The Administration intends to work with the SDE to develop a legislative proposal by the May Revision, at which time this estimate of implementation costs may be refined.

**School District Fiscal Accountability**—The number of local education agencies (LEAs) in fiscal distress has grown in recent years, as evidenced by an increase in districts with qualified and negative interim financial reports and by the necessity of providing bailout loans to three districts since 2001. In some of these instances, opportunities to correct problems early were not taken advantage of and there was confusion surrounding local and State responsibilities for fiscally troubled districts. The Administration is concerned that cost pressures and local budget decisions may lead to continuing trouble at the local level.

Given the fiscal problems many districts face, the Administration believes that current laws and procedures regarding school district budget oversight require reform. In order to improve the process and ensure greater fiscal stability among LEAs, the Administration specifically proposes the following:

- Provide greater specificity for definitions of fiscal insolvency and establish clear guidelines for budget projections.
- Provide clear authority for the Superintendent of Public Instruction to assign school budget experts to districts in fiscal distress.

- Modify the process regarding emergency loans and State takeovers for troubled LEAs in order to incorporate lessons learned from prior experiences.
- Require all district collective bargaining agreements to be subject to a 15-day review and comment on budget impact by the County Superintendent of Schools.
- Require districts to present a plan to the public to fully restore their reserve for economic uncertainty by the 2005-06 fiscal year, as required by statute.

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## Program Highlights

**K-3 Class Size Reduction**—The Budget proposes \$1.652 billion for this program in 2004-05. Although the program received a cost-of-living adjustment, a funding level based on current program participation rates results in a \$7 million reduction from the 2003-04 funding level. The Budget also proposes \$6.7 million in one-time funds for a 2001-02 shortfall in the program.

**Special Education**—The Governor's Budget fully funds the special education formula, including increases of \$70 million for a 1.84 percent COLA and \$37.4 million for growth. These adjustments are funded by an increase of \$74.5 million in federal funds, an increase of \$23.6 million in local property taxes, and \$9.3 million from the General Fund.

**Pupil Testing**—The Budget provides \$105.6 million, including federal funds, for various statewide exams. These assessments provide valuable information to parents, teachers, schools, and the State regarding pupil performance, and are the foundation of the State's accountability system for both State and federal purposes.

- **Standardized Testing and Reporting (STAR) Exam**— This exam, which serves as the primary indicator for the state's Academic Performance Index and the federal measure of Adequate Yearly Progress, measures pupil performance on various State-adopted content standards, coupled with a nationally normed exam in grades 3 and 8. The Budget includes \$65.5 million for this exam.



- **High School Exit Exam (HSEE)**— This exam helps to ensure that pupils who graduate from public high schools can demonstrate grade level competency in English-language arts and mathematics. Commencing with the Class of 2006, all pupils must pass the HSEE in order to receive a diploma. The Budget includes \$21.2 million for this exam.
- **California English Language Development Test (CELDT)**— This exam is required to be administered to pupils whose primary language is not English within 30 days of enrollment and annually thereafter to pupils identified as English language learners. This assessment allows schools to measure improvement in each student's English proficiency. The Budget includes \$18.8 million for this exam.

**Accountability**—The State has committed significant resources to improve the academic performance of low-performing schools. The need to continue this focus has not diminished. Therefore, the Budget continues to fund the following programs:

- **Immediate Intervention/Underperforming Schools Program (II/USP)**—The Budget provides \$77.4 million, including federal funds, for the third year of implementation funding for schools that made significant progress but did not reach their growth targets, as well as schools in the Comprehensive School Reform Program. Additionally, the Budget includes \$32.7 million, including federal funds, for sanctions for those schools that failed to make significant progress during the two years they were provided with implementation funding.
- **High Priority Schools Grant Program**—The Budget includes \$208.6 million, including federal funds, for the third year of funding for this voluntary program, which provides up to \$400 per pupil to participating low-performing schools to improve academic performance.

**Proposition 47 School Bonds**—In November 2002, voters approved Proposition 47, which provided \$11.4 billion in general obligation bond funds for K-12 school construction through the State School Facilities Program and \$1.65 billion for higher education facilities. As of December 10, 2003, the State Allocation Board has apportioned a total of \$9.7 billion to K-12 schools, with

a remaining balance of \$1.7 billion to be allocated in the near future.

### **New School Facilities General Obligation Bond—**

Proposition 55, a school facilities general obligation bond measure, is scheduled to appear on the March 2004 primary election ballot. If approved by the voters, the measure will provide \$10 billion for K-12 education facilities through the State School Facilities Program and \$2.3 billion for higher education facilities. The K-12 funding includes \$5.26 billion for new construction projects, \$2.25 billion for modernization projects, \$2.44 billion for critically overcrowded schools, and \$50 million for joint use projects. Within the proposed amounts, Proposition 55 provides a set-aside of \$300 million for charter school facilities.

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# HIGHER EDUCATION

## Overview

FIGURE HIED-1

### Higher Education Funding Total and General Funds (Dollars in Millions)

	2002-03	2003-04	2004-05	One-Year Change Amount	Percent
<b>University of California<sup>1/</sup></b>					
Total Funds	\$4,418.5	\$4,519.5	\$4,505.7	-\$13.8	-0.3%
General Fund	3,150.0	2,868.2	2,670.5	-197.7	-6.9%
<b>California State University<sup>1/</sup></b>					
Total Funds	3,525.9	3,677.2	3,587.9	-89.3	-2.4%
General Fund	2,697.1	2,622.5	2,409.6	-212.9	-8.1%
<b>Community Colleges</b>					
Total Funds	6,640.7	6,360.9	6,866.9	506.0	8.0%
General Fund & P98 <sup>2/</sup>	4,860.5	4,485.4	4,900.6	415.2	9.3%
<b>Student Aid Commission</b>					
General Fund	569.0	630.2	684.0	53.8	8.5%
<b>Other Higher Education<sup>3/</sup></b>					
Total Funds	180.6	211.6	318.9	107.3	50.7%
General Fund	165.0	191.9	293.6	101.7	53.0%
<b>Total Funds</b>	<b>\$15,334.7</b>	<b>\$15,399.4</b>	<b>\$15,963.4</b>	<b>\$564.0</b>	<b>3.7%</b>
<b>General Fund</b>	<b>\$11,441.6</b>	<b>\$10,798.2</b>	<b>\$10,958.3</b>	<b>\$160.1</b>	<b>1.5%</b>

<sup>1/</sup> For purposes of this table, expenditures for the University of California and California State University have been adjusted to include the offsetting general-purpose income. This provides consistency in comparing magnitudes and growth among the various segments of education.

<sup>2/</sup> For purposes of comparing with UC and CSU General Fund, CCC includes property tax revenue, as a component of the State's obligation under Proposition 98.

<sup>3/</sup> Other Higher Education includes the California Postsecondary Education Commission, Hastings College of the Law, and General Obligation Bond Interest and Redemptions for UC, CSU, and Hastings.

Notwithstanding the fiscal constraints associated with the significant structural imbalance inherited by the Administration, the Governor's Budget for higher education continues to recognize the significant contributions and benefits to society from broad access to higher education at the University of California (UC), the California State University (CSU), and California's Community Colleges (CCC).



Although it is necessary to reduce General Fund spending in both UC and CSU and curb unsustainable financial aid program growth, negative effects to core instructional programs are minimized through adoption of prudent fee increases, improved efficiency, and reductions to non-instructional programs. The Proposition 98 guarantee affords the ability to increase spending for CCC compared to the current year. Extra growth funding is provided to maintain access and accommodate expected new freshmen enrollments deferred from other segments, and funding also is provided for incentives that will assist students in transferring to the UC and CSU at a later date.

Significant policy changes reflected in the Budget include the following:

- **New Long-Term University Fee Policy**—This policy links future undergraduate and graduate fee increases to the change in per-capita personal income, but provides the ability to increase fees annually by no more than 10 percent. The graduate fee policy would increase at rates in excess of undergraduates until a 50 percent differential is achieved, which reflects the higher cost of instruction for these programs and the added benefit to those students afforded through advanced degrees. In this respect, fees are increased 10 percent for undergraduates and 40 percent for graduate students in the budget year. This new long-term policy will ensure that public university students are protected from future dramatic fee increases as a consequence of declines in General Fund resources.
- **Reduced Subsidy for Professional Students**—This policy proposes a 25 percent reduction to the current level of subsidies offered to professional students at UC and Hastings College of the Law (HCL), recognizing that most professional school graduates achieve significantly higher income levels after graduation than other graduates. Concurrently, the UC and HCL will be given maximum flexibility to determine the fee level for each profession that best addresses all factors including increasing fees to comparable public or private school levels and recognizing competitive factors, the State's need for certain professions, the cost of instruction, the current subsidy level, and the potential earnings for each specific professional school.

- **Eliminate Subsidy for Excess Units**—Students that take more than 110 percent of the required units necessary to achieve their major degree would pay the full cost for those extra courses. To avoid major hardships for existing students and allow the segments sufficient time to notify students of the new policy, the Administration proposes to phase in this provision over the next five years. The policy would also give the segments maximum flexibility to apply this principle to graduate level instruction.
- **Community College Fees**—California has the lowest fee in the nation, and holders of advanced education degrees pay the same fees as undergraduate students. California's low fee level also does not allow students to maximize federal Pell Grants and tax credits that would fully cover the costs of higher fees. The Budget therefore proposes to increase fees for undergraduates to \$26 per unit and to \$50 per unit for degree holders. The proposed fee level for undergraduates likely will remain the lowest in the nation, and the fees for degree holders will be significantly less than the average fees charged to community college students in other states.
- **Shift 10 percent Freshmen Enrollment to CCC**—Given current funding constraints, access to UC and CSU cannot be guaranteed for as many students as in the past. Nonetheless, because the CCC provides quality undergraduate instruction at significantly lower cost than UC or CSU, the CCC will be asked to accommodate the additional enrollments as a priority and are funded to do so. Further, the Administration proposes incentives for students accepting entry into a new dual enrollment program with CSU and UC, including CCC fee waivers and additional counseling and guidance services administered by UC and CSU to ensure successful transfer upon completion of lower division work.

The Administration's long-term student fee policy and other policy changes will have minimal effects on low-income students. Qualifying low-income students will continue to be eligible to receive federal Pell Grants and Cal Grants, and California's higher education segments will continue to provide financial aid to needy students. In addition, both UC and CSU will set aside 20 percent of their new fee revenue for financial aid, and CCC fee waivers will en-

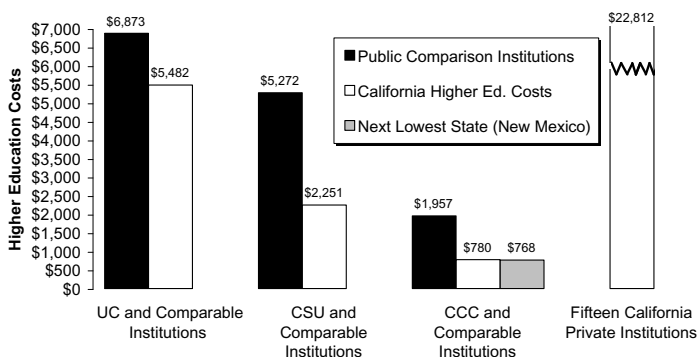


sure that needy students do not pay fees. Despite the fee increases proposed by the Administration, it is expected that California's fees will remain significantly below the average of comparable institutions, with the CCC system likely remaining the most affordable system in the nation (see Figure HIED-2).

Although the Governor's Budget contains no new funding for enrollment increases at UC or CSU due to the Legislature's direction in the 2003 Budget and the Administration's proposal in this Budget to reduce new freshmen enrollment by 10 percent, CSU expects its enrollment to increase by nearly 6,700 students and CCC enrollment is projected to increase by 33,000 students, for a total overall higher education enrollment of almost 1.7 million full-time equivalent (FTE) students.

**FIGURE HIED-2**

**Proposed Fee Levels Remain Low at California's Public Higher Education Institutions Compared to Tuition Levels in Other States and California's Private Institutions**



Fees for UC and CSU include the proposed 2004-05 10 percent increase. CCC fees reflect the proposed increase from \$18 per unit to \$26 per unit. Comparable institution data for UC and CSU reflect 2003-04 fee levels, while comparable CCC data are based on 2002-03 fees. The fees for UC and CSU include systemwide fees, only, and do not include campus-based fees of \$546 and \$526, respectively, because it is unknown whether similar fees are included in the comparable institution fee levels.

## University of California

The Governor's Budget provides total funding from all sources of \$4.5 billion for UC, a decrease of \$13.8 million or 0.3 percent below the 2003-04 level. This funding includes \$2.7 billion in General Fund resources, reflecting a reduction of \$197.7 million or 6.9 per-

cent below 2003-04, which reflects a 2003-04 mid-year General Fund spending reduction of \$29.9 million to UC's 2003-04 budget.

The Governor's Budget proposes the following General Fund reductions for 2004-05:

- \$45.4 million reduction to Academic and Institutional Support.
- \$35.2 million by increasing the student-to-faculty ratio by approximately 5 percent.
- \$33.3 million by eliminating General Fund support for out-reach activities.
- \$24.8 million by reducing by 10 percent the enrollment of new freshmen, resulting in approximately 3,200 fewer FTES.
- \$14.3 million by eliminating General fund support for the Digital California Program.
- \$11.6 million by reducing General Fund support for research by 5 percent.
- \$4 million by eliminating General Fund support for the Multi-Campus Research Units for Labor Studies.

Additionally, the following reductions are included which will be offset through higher fees or changes in student behavior:

- \$62.9 million through a 10 percent increase in the undergraduate fee.
- \$57.7 million through a 40 percent increase in the graduate fee.
- \$42.6 million by decreasing by 25 percent the General Fund subsidy for students in professional school programs other than nursing.
- \$32.6 million through a 20 percent increase in the surcharge for out-of-state students.
- \$9.3 million for the first phase of eliminating the General Fund subsidy for students who exceed by more than 10 percent the minimum number of units required to earn their degree.



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The Governor's Budget also proposes the following significant General Fund augmentations for UC:

- \$80.5 million to restore the one-time unallocated reduction implemented in 2003-04.
- \$10 million in one-time funding for costs associated with making the UC Merced campus operational in 2005-06.
- \$34.4 million for increases in annuitant health and dental benefit costs.
- \$1.6 million to provide counseling services to otherwise UC-qualified freshmen who may enroll in a CCC as a result of the proposed 10 percent reduction in new freshmen.

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## California State University

The Governor's Budget provides total funding of nearly \$3.6 billion for CSU, a decrease of \$89.3 million or 2.5 percent below the 2003-04 level. The funding level includes \$2.4 billion in General Fund resources, a reduction of \$212.9 million or 8.1 percent below the 2003-04 level, which reflects a 2003-04 mid-year General Fund spending reduction of \$23.7 million to CSU's 2003-04 budget.

Although the General Fund reductions proposed for CSU are similar to those proposed for UC, the net impact on CSU is less, since CSU also is receiving a significant General Fund augmentation for increased PERS costs. UC's PERS augmentation is considerably less, since most of its employees do not participate in PERS.

The Governor's Budget proposes the following General Fund reductions for 2004-05:

- \$52.6 million reduction to Academic and Institutional Support, which equates to approximately a 7.5 percent reduction for these functions.
- \$53.5 million by increasing the student-to-faculty ratio by approximately 5 percent.
- \$52 million by eliminating General Fund support for outreach activities.

- \$21 million by reducing by 10 percent the enrollment of new freshmen, resulting in approximately 3,800 fewer FTES.
- \$6 million by deferring 10 percent of General Fund support for the Common Management System.

Additionally, the following reductions are included that will be offset through higher fees or changes in student behavior:

- \$47.4 million by increasing undergraduate fees by 10 percent.
- \$37.9 million by increasing graduate fees by 40 percent.
- \$24.4 million for the first phase of eliminating the General Fund subsidy for students who exceed by more than 10 percent the minimum number of units required to earn their degree.
- \$16.2 million by increasing by 20 percent the surcharge for out-of-state students.

The Governor's Budget also proposes the following significant General Fund augmentations for CSU:

- \$155 million for increased PERS retirement contribution costs beginning in the current year.
- \$69.5 million to restore the one-time unallocated reduction implemented in 2003-04.
- \$1.9 million to provide counseling services to otherwise UC-qualified freshmen who may enroll in a CCC as a result of the proposed 10 percent reduction in new freshmen.

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## **California Community Colleges**

The Governor's Budget includes nearly \$6.9 billion from all sources for the CCC, representing an 8 percent increase over 2003-04 funding levels. This funding includes \$4.9 billion from the General Fund and Proposition 98 sources, up \$415.2 million or 9.3 percent over 2003-04 levels, and raises the CCC share of the Proposition 98 guarantee over 10 percent.



The Budget also reflects limited categorical reforms that increase available discretionary funding, minimize administrative burdens, and maintain accountability for state priority student outcomes. The proposed program consolidations are based either upon programs currently having similar funding mechanisms or related purposes, and will allow each CCC district to better address its own unique needs, student populations, job environments, and local expectations.

The following significant Proposition 98 adjustments are included in the Governor's Budget:

- \$125.1 million augmentation for enrollment growth of 3 percent, exceeding the statutory growth requirement of 1.83 percent. This funding will provide access for an additional 33,000 FTE students, for a total of 1.137 million FTE students in 2004-05. Additionally, attrition savings anticipated as a result of fee increases are not captured, allowing districts the flexibility to provide instruction and services to additional students.
- \$80 million for equalization, to reduce disparities between districts currently funded below the 90th percentile of per-FTEs funding systemwide through an allocation formula consistent with the one used for K-12 districts.
- \$91 million reduction, to be offset by proposed fee increases for undergraduates and holders of advanced educational degrees.
- A permanent reduction of \$1.87 million and 32.5 positions from the Chancellor's Office, beginning in 2003-04, pursuant to the requirements of Control Section 4.10 of the 2003 Budget Act.

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## Financial Aid Programs

The Governor's Budget provides \$684 million General Fund for the California Student Aid Commission's financial aid grant programs in 2004-05, an increase of almost \$53 million after the 2003-04 mid-year spending reduction proposal is considered. The mid-year proposal includes General Fund Cal Grant reductions of \$50 mil-



lion for the current year, reflecting estimated savings in the cost of awards from the amount estimated in the 2003 Budget Act. The augmentations proposed for 2004-05 are as follows:

- \$43.7 million for growth in the Cal Grant Program, reflecting a net \$93.7 million year-to-year increase from the revised 2003-04 level projected by the Commission.
- \$2.1 million for growth in the Assumption Program of Loans for Education Program (APLE) and Law Enforcement Personnel Dependents Program.

To help control the rapid growth in costs of Cal Grants and other financial aid programs in context of the current fiscal situation, the Governor's Budget also proposes the following reductions and policy changes:

- \$32.7 million by reducing the maximum Cal Grant award for students at private colleges and universities from \$9,708 per year to \$5,482 per year—equivalent to what the annual undergraduate fee will be at UC, after the proposed 10 percent increase takes effect in 2004-05. This proposal would not affect recipients who received an award issued before 2004-05.
- \$11.2 million by reducing by 10 percent the maximum allowable income for Cal Grant recipients. This proposal would not impact recipients who received an award issued before 2004-05.
- The Administration proposes to decouple Cal Grant awards from the tuition levels at UC and CSU. Otherwise, following current policy would require that Cal Grant awards be increased to cover the proposed undergraduate fee increases proposed for UC and CSU. This avoids approximately \$23.6 million in additional General Fund costs in 2004-05.
- The Governor's Budget reduces the number of APLE warrants from 7,700 to 3,500, consistent with the proposed change in the 2003-04 Mid-Year Spending Reduction Proposal. Reducing the annual number of new awards will save out year costs of as much as \$46 million for each cohort as the warrants are redeemed.

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# HEALTH AND HUMAN SERVICES

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## Department of Health Services

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### Medi-Cal

The Governor's Budget proposes \$31.2 billion (\$11.6 billion General Fund) for the Medi-Cal program in 2004-05, a General Fund increase of 16.2 percent above the 2003 Budget Act. The General Fund increase primarily reflects the cost of using one-time savings in 2003-04 from the accrual-to-cash accounting change within the Medi-Cal program and the enhanced Federal Medical Assistance Percentage (FMAP) received in 2003-04 as a result of Section 401(a) of the federal Jobs and Growth Tax Relief Reconciliation Act of 2003.

Since 1998-99, Medi-Cal beneficiaries have increased from 5 million eligibles to nearly 6.8 million eligibles projected for 2004-05, an increase of 1.8 million beneficiaries.

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### Improving Accountability and Service Delivery

Generally speaking, since Medi-Cal costs are driven by the number of eligibles, the services provided, and the rates paid to providers for the services, options for controlling costs include serving fewer people (for example, by eliminating recent eligibility expansions), providing fewer services (for example, by eliminating optional benefits), or reducing rates paid to providers.

To begin the process of reducing escalating, unsustainable costs, the 2003-04 Mid-Year Spending Reduction Proposals included



solutions to achieve General Fund savings of \$206.9 million in 2003-04 and \$479.4 million in 2004-05, as follows:

- Additional 10 percent rate reduction for specified Medi-Cal providers, including physicians, non-emergency medical transportation, home health, and other medical providers and services, achieving General Fund savings of \$160.9 million in 2003-04 and \$462.2 million in 2004-05.
- Elimination of the Wage Adjustment Rate Program, which was established in 2000-01 to provide supplemental payments to long-term care facilities that have a collectively bargained agreement to increase salaries, wages, or benefits for caregivers, to achieve General Fund savings of \$46 million in 2003-04.
- Capping enrollment in Medi-Cal for immigrants at the January 1, 2004, level (909,500 beneficiaries), to achieve General Fund savings of \$17.2 million in 2004-05.

**Medi-Cal Reform**—The Governor's Budget embraces an alternative, strategic approach to controlling costs in the Medi-Cal program. It proposes to reform the Medi-Cal program, so that in the long-term, Medi-Cal can be flexible enough to meet the medical needs of beneficiaries at costs that are affordable to the State. Reform strategies could include simplification, a multi-tiered benefit structure for mandatory and optional beneficiaries, co-payments, eliminating some Medi-Cal services that exceed standard private health insurance benefit packages, and expansion of managed care. This proposal may not result in General Fund savings in the budget year (no savings are included in the Budget) as a result of the lengthy process of reforming the existing Medi-Cal eligibility, benefit, and managed care structure, as well as securing State and federal approvals. The Administration intends to engage numerous stakeholders and constituencies in this effort. Implementation is expected to begin in 2005-06, and would use a phased-in approach, allowing the State to monitor the progress, and make adjustments as needed as implementation issues arise. It is anticipated that a minimum of \$400 million General Fund savings will be achieved in 2005-06. Other states have undertaken similar program reforms and achieved long-term program savings ranging from 5 percent to 10 percent.

**Medi-Cal Anti-Fraud and Audit Efforts**—The Governor's Budget also proposes to expand the Medi-Cal anti-fraud and audit efforts, as well as implement other program enhancements and efficiencies. Anti-fraud efforts implemented since 2000-01 have resulted in General Fund savings of \$371 million and cost avoidance of \$352 million. The Governor's Budget includes the following proposals to further enhance efforts to combat fraud, waste, and abuse in the Medi-Cal program:

- **Enhance Medi-Cal Estate Recoveries and Increase Long-Term Care Insurance Purchases**—This proposal would close a loophole used by middle-income persons to prevent the State from recovering assets from their estates, achieving General Fund savings of \$237,000 in 2004-05. Concurrent with this proposal, the Department of Health Services (DHS) would continue to increase the number of middle-income persons purchasing long-term care insurance, which serves to control Medi-Cal program costs.
- **Expand Hospital Billing Audits**—This proposal would increase the number of field audits of fee-for-service (non-contract) hospital cost reports, home office cost reports, and related billings. The Governor's Budget proposes an additional 41 staff for the DHS to achieve net General Fund savings of \$1.4 million in 2004-05 and \$15.3 million annually thereafter.
- **Provider Feedback**—This proposal would allow the DHS to send mid-year billing data to Medi-Cal providers with suspicious billing patterns, achieving General Fund savings of \$2.5 million in 2004-05.
- **Beneficiary Confirmations**—This proposal would allow the DHS to confirm receipt of services or products with selected Medi-Cal beneficiaries via mail or on-site visits, achieving General Fund savings of \$1 million in 2004-05.
- **Restrict Electromyography and Nerve Conduction Tests to Specially-Trained Physicians**—This proposal would restrict billing to neurologists, physical medicine, and rehabilitation-trained physicians who have received specialized training in electromyography and nerve conduction tests, achieving General Fund savings of \$652,000 in 2004-05 and \$1.1 million annually thereafter.



- **Implement Counterfeit-Proof Prescription Pads**—This proposal would require all prescriptions for Medi-Cal beneficiaries to be written on prescription blanks obtained from State printing vendors, which would reduce forging and/or altering of prescriptions and provide an inventory of prescribers' drug orders. As there would be significant lead-time required for implementation of this proposal, there would be no savings in 2004-05. However, General Fund savings are estimated to be between \$7 million and \$14 million in 2005-06, with annualized savings increasing as the deterrent factor would also generate savings over time.
- **Convert 15 Limited-Term Medi-Cal Anti-Fraud Positions to Permanent**—The Budget Act of 2002 established 40 DHS positions for Medi-Cal anti-fraud activities. These positions, 15 of which will otherwise expire June 30, 2004, perform provider enrollment and re-enrollment reviews to identify, investigate, and remove fraudulent providers from the Medi-Cal program. Fifteen of these positions were established as limited-term to provide an opportunity to review the effectiveness of these positions. As a result of these additional 40 positions, savings due to Medi-Cal provider enrollment reviews increased from \$35.9 million (\$17.9 million General Fund) in 2001-02 to \$59.7 million (\$29.9 million General Fund) in 2003-04. The Governor's Budget proposes to provide \$1,239,000 (\$443,000 General Fund) to continue these limited-term Medi-Cal anti-fraud positions permanently.
- **Transfer Medi-Cal Audit Positions from State Controller's Office (SCO) to the DHS**—This proposal would shift the workload to 20 new positions at the DHS. This proposal would not change the amount of local assistance Medi-Cal savings due to anti-fraud activities, but it would reduce state operations costs for this workload by approximately \$300,000 General Fund due to efficiencies achieved, and would provide better coordination.
- **Reduce Medi-Cal Provider Float**—This proposal would delay Medi-Cal checkwrites by one week, to allow additional time for the DHS to investigate potentially fraudulent claims before checks are issued, achieving one-time General Fund savings of \$143.5 million in 2004-05. The Administration anticipates

that the one-time savings would be replaced with some level of ongoing savings from reduced fraud.

### Program Enhancements and Other Budget Adjustments

- **Assess Quality Improvement Fee on Medi-Cal Managed Care Plans**—The Governor's Budget proposes to allow the DHS to assess a 6 percent quality improvement fee on all lines of business within the Medi-Cal managed care plans as a vehicle for leveraging and receiving additional federal funding. Medi-Cal managed care plans wishing to participate would be required to break off the Medi-Cal portion of their business into a separate entity as a condition of federal approval. This proposal would generate additional federal funding for the health plans and would result in savings of \$75 million for the General Fund in 2004-05.
- **Controlling County Administration Costs within the Medi-Cal Program**—Because counties do not share in either the administrative or benefit costs of Medi-Cal, there is no incentive for counties to control Medi-Cal costs. The Governor's Budget proposes to implement a formal plan to control county welfare department allocations for Medi-Cal eligibility determinations. The DHS would submit a control plan to county welfare departments in January 2005, including productivity standards and overall performance standards. Budget bill language is also proposed to restrict county wage increases to specified cost-of-living adjustments (COLAs), with the intent of reducing the wide disparity in efficiency that exists among the different counties. This proposal would result in General Fund savings of \$10 million in 2004-05, with savings reaching \$20 million at full implementation.
- **Adult Day Health Care Reform**—This proposal would institute Adult Day Health Care (ADHC) reform by implementing a one-year moratorium on new ADHC centers and a moratorium on certification for increased capacity of existing ADHC centers. These centers would continue to be licensed by the DHS and would continue receiving private pay reimbursement. This proposal would also remove therapy and transportation from the bundled ADHC reimbursement rate, allowing the ADHC centers to bill for these services separately. This



proposal would result in General Fund savings of \$12.7 million in 2004-05.

- **Reduce Interim Rates by 10 percent for Cost Reimbursed Acute Care Hospitals**—The Governor's Budget proposes to reduce, by 10 percent, the interim rate paid to acute care hospitals effective December 1, 2003. The hospitals would continue to be cost-settled at the end of the fiscal year, when the DHS has received and audited the hospitals' cost reports. This proposal would not reduce the total Medi-Cal payments for hospital inpatient services, but would result in General Fund savings of \$18.1 million in 2003-04 and \$31 million in 2004-05.
- **Revise Rate Methodology for Federally Qualified Health Centers and Rural Health Clinics**—These facilities, clinics that serve a large portion of the low-income population, receive enhanced reimbursement from Medicare and Medi-Cal. Federal legislation required reimbursement to these facilities be changed to a Prospective Payment System effective January 1, 2001. The new rates were to be calculated using the average of the 1999 and 2000 cost reports. However, the prior Administration allowed the election of only the 2000 cost report as an alternative rate methodology. Additionally, the calculation of these rates was based on reported, un-audited cost information, resulting in an overstatement of costs in some instances. This proposal would seek federal authority through a State Plan Amendment to eliminate the alternative rate methodology, and to recalculate and set the rates prospectively using the average of the 1999 and 2000 cost reports, as was originally required in the federal legislation, and base the rates on audited or reconciled cost information. This proposal would result in General Fund savings of \$3.8 million in 2003-04 and \$32.2 million in 2004-05.

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## Public Health

The DHS administers numerous public health programs to prevent disease and premature death and to enhance the health and well being of all Californians. Expenditures for all public health programs and state operations total \$3 billion (\$631.6 million General



Fund) in 2004-05. This represents a decrease of \$55.6 million, or 8.1 percent, below General Fund expenditures in the 2003 Budget Act. The Governor's Budget includes the following major funding adjustments:

- **Mid-Year Spending Reductions**—Continuing the reductions proposed during the 2003-04 Special Session and to institute controls on unsustainable spending growth, the 2004-05 Governor's Budget includes enrollment caps proposed for the Genetically Handicapped Persons Program (GHPP), the California Children's Services Program (CCS), and the Acquired Immune Deficiency Syndrome (AIDS) Drug Assistance Program (ADAP). In doing so, the Governor's Budget will continue to serve in the budget year up to 1,679 clients in the GHPP, approximately 37,600 clients in the CCS, and approximately 26,500 clients in the ADAP. These proposed enrollment caps will result in a combined savings of \$2.6 million General Fund.
- **Bioterrorism Prevention**—The Governor's Budget proposes \$108.9 million federal funds and 94.8 positions to enhance California's public health system's preparedness and response to bioterrorism, outbreaks of infectious diseases, and other public health threats and emergencies in 2004-05. In response to the heightened threat of bioterrorism, Congress authorized funding through the Public Health and Social Services Emergency Fund to support activities related to countering potential biological threats to the civilian population. Funding represents the 2004-05 portion of grants the DHS will receive from two separate federal agencies: the Centers for Disease Control and Prevention (CDC), and the Health Resources and Services Administration (HRSA).
- **GHPP Co-Payment Plan**—The Governor's Budget proposes to implement co-payments in the GHPP. This proposal would result in savings of approximately \$576,000 General Fund and will continue to maintain the same level of overall program funding which will serve an estimated 1,679 clients in the budget year.



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## Other Public Health Augmentations

- **Richmond Laboratories**—\$1.3 million (\$424,000 General Fund) in 2004-05 to install and maintain technology systems that support Phase III of the Richmond Laboratory Campus construction. This phase will complete consolidation of various laboratories and offices into one State facility.
- **Vital Records**—\$1.6 million special funds and 6.0 limited-term positions for the Vital Records Statewide Database are proposed for 2004-05. Implementation of a statewide database will allow State health offices to provide automatically-redacted copies of vital records to the public, and, thereby, protect privacy and help prevent fraudulent use of public records.
- **Electronic Death Registration System (EDRS)**—\$388,000 in special funds for the maintenance and operation of the EDRS is proposed for 2004-05. The System will provide automation of vital statistics on a statewide basis and will help address identity theft and related fraud by providing faster record review and administrative access.

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## Proposition 99 Expenditures

Californians continue to use fewer tobacco products each year, in part as a result of the effectiveness of the Tobacco Tax and Health Protection Act of 1988 (Proposition 99). Consequently, estimated revenues for 2003-04 will decline \$15.2 million. In 2004-05, total resources will be \$36.5 million below the 2003 Budget Act level, or \$323.1 million. Due to these declining revenues and higher expenditures in the Managed Risk Medical Insurance Board (MRMIB) programs, Proposition 99 funding to other health programs will decrease, as noted below:

- **2003-04 Expenditures**—The Governor's Budget includes expenditures of \$141.3 million to fund existing DHS programs, except for decreases of \$1.7 million in the California Healthcare for Indigents Program (CHIP) and \$3.2 million in DHS Health Education expenditures. University of California

Research will decline by \$2.2 million and the Department of Education expenditures by \$1.5 million.

- **2004-05 Expenditures**—The Governor's Budget proposes expenditures of \$123.4 million for DHS Proposition 99-funded programs in 2004-05. Funding for various MRMIB programs was increased by \$5.7 million. Due to lower revenues, funding for health programs decline by an average of 15.5 percent. Proposed decreases include the following:

- \$8 million for Health Education programs.
- \$7.4 million for University of California Research.
- \$6.1 million for the Breast Cancer Early Detection Program.
- \$4.2 million for the California Healthcare for Indigents program.
- \$3.6 million for the Department of Education.
- \$2.2 million for the various resources departments.

## Managed Risk Medical Insurance Board

**Healthy Families Program (HFP)**—This program is a subsidized health insurance program for children in families with low-to-moderate income who are ineligible for no-cost Medi-Cal. This program provides low-cost health, dental, and vision coverage to eligible children from birth to age 19.

HFP expenditures for the Managed Risk Medical Insurance Board (MRMIB) grew from \$59.3 million (\$15.6 million General Fund) in 1998-99 to \$839.1 million (\$305.5 million General Fund) in 2004-05, an increase of \$289.9 million General Fund, or 1,858 percent. Since year-end 1998-99, children's caseload has grown from about 132,000 to an expected 732,000 children by June 30, 2004, and 737,000 in 2004-05 for a total increase of 605,000 children, or 458 percent. To address the significant, unsustainable growth in HFP expenditures, the Administration proposes to control future program expenditures by capping enrollment in the near term and providing higher-income pro-



gram subscribers with a choice of benefit packages in the long term. These proposals would not disenroll any current program subscribers.

- **Cap Healthy Families Enrollment**—As proposed in the Mid-Year Spending Reduction Proposals, enrollment in the HFP would be capped at the January 1, 2004, level, or an estimated 732,300 children. Waiting lists will be established and as attrition occurs, new enrollments will be accepted. This proposal would not result in current year savings due to the increased administrative costs to maintain the waiting list, but is expected to result in budget year savings of \$86.3 million (\$31.5 million General Fund).
- **Two-Tiered Benefit Structure for Children with Family Incomes Between 201 percent and 250 percent of the Federal Poverty Level (FPL)**—Children enrolled in the program with family incomes between 201 percent and 250 percent of the FPL (monthly income between \$2,544 and \$3,180 for a family of three) would be offered a choice of benefit packages. A two-tiered benefit package is proposed—a basic benefit package would be offered excluding dental and vision coverage at current premium levels, and a comprehensive package would include all benefits with higher monthly premiums. Due to the need to notify subscribers of the new benefit options, this proposal would not be implemented until 2005-06, and no savings are assumed in 2004-05.

**Access for Infants and Mothers (AIM)**—This program provides low-cost, comprehensive health insurance coverage to uninsured pregnant women up to 60 days post-partum and their infants up to two years of age with family incomes between 200 percent and 300 percent of the FPL. The Governor's Budget includes a total of \$117.3 million (\$98.6 million Perinatal Insurance Fund) for this program, a net decrease of \$750,000 (\$1.2 million General Fund decrease, \$2.6 million Perinatal Insurance Fund increase, and \$2.2 million federal fund decrease) below the 2003 Budget Act. These funding changes reflect updated caseload estimates, as well as the shift of certain infants born to AIM mothers into the HFP, in accordance with the omnibus health trailer bill to the 2003 Budget Act. Since 1998-99, caseload has grown from 6,288 women and infants to a total of 14,139 women and infants in 2004-05, or an increase of 125 percent.

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## Department of Social Services

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### California Work Opportunity and Responsibility to Kids

The Governor's Budget includes total California Work Opportunity and Responsibility to Kids (CalWORKs) expenditures of \$6.4 billion, which includes \$4.7 billion for CalWORKs program expenditures within the Department of Social Services budget, \$1.5 billion in other programs, and \$158.4 million for a CalWORKs program reserve. Other programs include the Statewide Automated Welfare System, Child Welfare Services, California Food Assistance Program, State Supplementary Payment, Foster Care, California Department of Education child care, California Community Colleges child care and education services, Department of Child Support Services (DCSS) disregard payments, the Department of Development Services, and county expenditures. Caseload growth is continuing to flatten after many consecutive years of decline. The revised caseload projections are 479,000 cases in 2003-04, and 481,000 cases in 2004-05.

- **CalWORKs Employment Services**—The Administration continues to invest in employment services, which allows recipients to move off of aid and into sustainable employment. The Budget includes an augmentation of \$191.9 million for employment services in 2003-04 and 2004-05. In addition, funding for employment services and administration in 2003-04 is increased by \$47.2 million above the 2003 Budget Act appropriation to fully fund projected caseload.
- **Temporary Assistance for Needy Families (TANF) Reserve**—The Budget includes a \$158.4 million TANF reserve to be available for unanticipated needs. A reserve of this magnitude is needed to mitigate the impact of several CalWORKs program pressures, including the reauthorization of the federal TANF program.

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### Tightening Work Participation Requirements

The Administration proposes reforms that reduce program costs while tightening work participation requirements, creating greater



incentives to work, and strengthening sanctions for not working. This proposal would create a stronger incentive for families to rely on program assistance for only a temporary period of time and to move quickly into employment and off of aid. The CalWORKs reform proposal includes the following three key elements:

- Requires families to participate at least 20 hours per week in core work activities within 60 days of the receipt of aid.
- Reduces the child-only grant by 25 percent for families that fail to meet work participation requirements within one month of being sanctioned.
- Reduces by 25 percent the child-only safety net grant that is provided to families that have reached their lifetime time limit and who are not working.

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### **Prioritize Funding to Move Recipients into Sustainable Employment**

To adhere to the policy of maintaining program costs within the TANF Block Grant and TANF maintenance-of-effort level, the Administration proposes to prioritize funding to invest in services that enable recipients to leave aid and become self sufficient. The following reductions accomplish this goal:

- Reduce CalWORKs grant levels by 5 percent as proposed in the Administration's mid-year spending reduction proposal, and suspend the CalWORKs grant COLA for 2004-05.
- Reduce funding for services to at-risk youth by \$134.3 million, leaving a total of \$67.1 million for prevention, intervention, supervision, treatment, and incarceration programs for at-risk youth and juvenile offenders. In addition to the \$67.1 million in federal TANF funding for county probation departments, the Budget includes \$100 million General Fund for Juvenile Justice Crime Prevention grants.
- Eliminate funding for three small discretionary programs for low-income women requiring alcohol and other drug treatment services, at-risk youth, and Native Americans requiring mental health and substance abuse services.

- Reduce by \$30.5 million the amount of State funding provided to the tribal entities to reflect declining tribal caseload.

## **Supplemental Security Income/ State Supplementary Payment Program**

Total General Fund expenditures for the Supplemental Security Income/State Supplementary Payment (SSI/SSP) program are projected to be over \$3.3 billion, a decrease of \$33.9 million, or 1 percent, from the 2003 Budget Act. Program caseload is estimated to increase to 1.2 million recipients in 2004-05, a 2.1 percent increase over the 2003-04 projected level.

Given the State's severe fiscal constraints, and to control the unsustainable costs in the SSI/SSP program, the Administration proposes that the January 2005 State COLA of 2.8 percent be suspended, and the pass-through of the January 2005 federal COLA of 1.8 percent be withheld for General Fund savings of \$134.7 million in 2004-05 and \$269.4 million annually thereafter. The overall grant payment standards will not decrease and will remain at the current levels of \$790 for an individual and \$1,399 for a couple. These grant levels reflect a 2.1 percent federal COLA that was passed through effective January 1, 2004.

**Mid-Year Spending Reduction Proposal**—The Administration has proposed to eliminate the California Veterans Cash Benefit Program for certain veterans who no longer reside in the United States, for General Fund savings of \$5.5 million.

## **In-Home Supportive Services**

General Fund expenditures in the In-Home Supportive Services (IHSS) program are projected to be \$899.4 million in 2004-05, a 373.5 million, or 29.4 percent, decrease from the 2003 Budget Act. In the absence of programmatic changes to reduce costs, costs are projected to increase 9.4 percent above the 2003 Budget Act. Given the State's severe fiscal constraints, and to control the unsustainable costs in the IHSS program, the Administration proposes to reduce the cost of providing services in the IHSS program and require immediate family members to meet more of the responsibility and/or costs for caring for disabled and elderly



persons, to avoid further, more significant, reductions to services. The reductions include: (1) reducing State funding for IHSS worker wages and benefits for General Fund savings of \$98 million, (2) making optional to counties the employer-of-record requirement for General Fund savings of \$987,000, (3) making optional to counties the advisory committees requirement for General Fund savings of \$1.2 million, and (4) eliminating domestic and related IHSS services in shared living situations for General Fund savings of \$26.3 million.

**Mid-Year Spending Reduction Proposal**—The Administration has proposed to eliminate the State-only Residual Program, which provides payments to parent and spouse caregivers, among other things. Many of these clients, however, will be eligible for the federally-funded portion of the IHSS program. This results in General Fund savings of \$88.8 million in 2003-04 and \$365.8 million General Fund annually, beginning in 2004-05.

Lastly, the Administration intends to submit a proposal in the spring to improve the quality of IHSS need assessments and reduce over-authorization of service hours. This would address the State-level case reviews finding that up to 25 percent of all paid services under the IHSS program may be unnecessary or not actually provided.

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## Foster Care

**Foster Care Reform**—The Budget includes \$1.1 billion (\$470.1 million General Fund) for foster care grants and administration. General Fund expenditures in the Foster Care Program have grown by 23 percent from 1998-99 to the 2003 Budget Act, while program caseload has declined by 9 percent during the same period. The primary reason for the cost growth has been increased placements in higher-cost Foster Family Agencies (FFA) and Group Homes.

To curtail growth in program expenditures and to improve outcomes for children, the Administration proposes program reforms to promote the care of more children in a family home environment and to shorten the period of time children spend in foster care, particularly more restrictive placements such as group homes. These proposals are expected to save approximately



\$20 million in 2004-05 and increasing amounts in out-years. Potential proposals could include the following:

- Restructuring the rates paid by the State for foster care facilities to encourage counties to increase the use of less-restrictive, less-costly placements and to establish a standard statewide rate for other high-cost specialized foster care services and payments.
- Requiring the higher-cost, higher-growth foster care providers (FFAs and Group Homes) to operate under performance-based contracts to require them to meet federal and State outcome measures, as a condition of payment.
- Pursuing a flexible funding waiver to apply federal foster care funds for flexible child welfare purposes including, prevention of child abuse and neglect, and intensive services to keep children with their birth parents and reduce out-of-home placements.

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### Programs for Immigrants

The Administration proposes to restructure and consolidate a number of health and human services programs for immigrants and fund them in a single block grant to be provided to counties to provide basic safety net services to this population. These programs include CalWORKs for recent documented immigrants, California Food Assistance Program, Cash Assistance Program for Immigrants, and Healthy Families Program for documented immigrants. The 2004-05 Governor's Budget reflects savings of \$6.6 million General Fund due to anticipated efficiencies resulting from this proposal.

**Mid-Year Spending Reduction Proposal**—The Administration has proposed to cap enrollment in a number of programs for immigrants to achieve General Fund savings of \$25 million in 2004-05.

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### Department of Developmental Services

The Budget includes \$3.4 billion (\$2.2 billion General Fund), an increase of \$129 million (\$55.9 million General Fund) above the



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2003 Budget Act for programs serving more than 200,000 persons with developmental disabilities.

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## Regional Centers

The Governor's Budget includes a net increase of \$154.4 million (\$108 million General Fund) over revised current year estimates for 2004-05 due to increased caseload, higher service utilization rates, and the transfer of the habilitation services program from the Department of Rehabilitation effective July 1, 2004. The regional center population is projected to increase by 6,195 consumers, to nearly 200,000.

The Governor's Budget does not propose to create a cap on caseload or eliminate services, and presents an alternative approach to achieve savings while continuing to provide services to everyone that is eligible. These proposals recognize that program costs have grown 244 percent over the past ten years, and that California cannot sustain future growth and costs of this magnitude. Major program changes include the following:

- **Regional Center Cost Containment**—Anticipated savings of \$100 million General Fund by requiring a co-payment from those who can afford to pay, a requirement that services be provided in the least costly manner possible, and the implementation of statewide purchase of service standards across the 21 regional centers.
- **Transfer of Title XX Grant Funding to Regional Centers**—A reduction of \$48 million General Fund to reflect a shift of Title XX funding to regional centers.
- **Unallocated Reduction to Regional Center Administration**—A reduction of \$6.5 million General Fund to achieve savings in the regional centers operations.

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## Developmental Centers

The developmental center budget includes a decrease of \$24.8 million (\$5.1 million General Fund increase) compared to the revised current year estimates as the result of a decreasing

population. The developmental center population is projected to decline by 160 consumers from 3,550 to 3,390.

As the developmental center population continues to decline, and the community's capacity to support individuals with significant medical needs expands, there will be more opportunities to provide services to individuals in the community. As part of the Agnews Developmental Center closure plan, due to the Legislature April 1, 2004, the Administration will begin to address the long-term strategy for operation of the developmental center system.

**Increased Contracting for Non-Direct Care Services**—The Administration proposes that developmental center food services be provided through contract, to produce more cost-effective and higher-quality services for developmental center residents.

## Department of Mental Health

The Governor's Budget includes \$2.5 billion (\$910.7 million General Fund), a net increase of \$373.4 million (\$39 million General Fund) above the 2003 Budget Act for mental health programs.

**State Hospitals**—The Governor's Budget includes \$702.4 million (\$560.8 million General Fund), a net increase of \$31.6 million (\$36.4 million General Fund) above the 2003 Budget Act for state hospitals. This funding level will support a total caseload of 4,605 state hospital commitments. Over the last ten years, the General Fund of operating the four state hospitals has increased 124 percent. In order to address both the increased per patient costs and unsustainable General Fund expenditures, it is necessary to reform how state hospital services and related clinical functions are provided to mentally ill individuals with criminal histories. The following significant adjustments are included in the 2004-05 Budget:

- **Indeterminate Commitment of Sexually Violent Predators (SVPs)**—A reduction of \$2 million General Fund by changing the SVP commitment from two years to an indeterminate length in order to eliminate unnecessary evaluations and re-commitment trials.



- **SVP Treatment Reform**—A decrease of \$823,000 General Fund to reflect proposed restructuring of the supervision and treatment services provided to SVP patients. Savings from this reform are estimated to be \$9.2 million beginning in 2005-06.
- **Civil Commitment Trials Held Prior to Release from Prison**—As conducted in other states, the Budget proposes holding SVPs in local custody if they have completed a prison sentence and are awaiting a commitment hearing. Savings of \$10.7 million General Fund are estimated in 2004-05.
- **Maintain State Hospital Population**—An anticipated savings of \$2.8 million (\$3.7 million General Fund) to reflect a proposal to prioritize patient intake based on the need for treatment. This proposal is necessary to curtail the unsustainable growth in General Fund expenditures for judicially committed patients.

**Early Periodic Screening Diagnosis and Treatment Program (EPSDT)**—This program entitles approximately 170,000 Medical eligible children and young adults to receive any service that ameliorates a diagnosed mental illness. The Administration is committed to continuing vital mental health services for children and young adults, and the Budget includes \$787 million (\$365 million General Fund) to maintain these services.

However, in the last five years General Fund expenditures increased by 285 percent and the 2004-05 Governor's Budget proposes several measures that will allow California to continue to provide necessary mental health services to children and young adults.

The following significant adjustments are included in the 2004-05 Budget:

- **Update Maximum Rates**—An adjustment of rates based on a survey of actual costs as indicated under the State's federal plan is estimated to generate savings of \$40 million General Fund.
- **Increased Oversight**—A net savings of \$5.7 million General Fund to reflect the implementation of targeted audits of claims.

- **Federal Relief**—Consistent with the larger Medi-Cal reform effort, the State will also pursue federal authority to narrow the very broad medical necessity criteria, in order to allow California to maintain its commitment to the children and young adults most in need of mental health services.
- **Restructuring of Existing Programs**—Given the availability of a wide range of medically necessary services and large numbers of needy children and young adults receiving services under the EPSDT program, it is no longer necessary to continue the Children's System of Care program.

**Community Mental Health Services**—The Budget includes \$1.8 billion (\$298.6 million General Fund), a net increase of \$304.2 million compared to the 2003 Budget Act, for community mental health services. The Administration remains committed to providing mental health services through the following programs:

- **Managed Care**—An increase of \$10 million (\$5.1 million General Fund) to reflect increased caseload.
- **Integrated Services for the Homeless**—The Budget continues funding of \$54.9 million General Fund for the Integrated Services for Homeless Adults program. This program has a proven track record of success in treating and providing services to the mentally ill, and provides essential fiscal relief to counties in these difficult times.
- **Preadmission Screening and Residential Review**—An increase of \$1.9 million (\$470,000 General Fund) is proposed for the expansion of the Preadmission Screening and Residential Review Program. Through this program, individuals admitted to nursing homes are evaluated to determine if specialized mental health treatment alternatives that are available in communities at lower costs, can better meet their needs.



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## Department of Alcohol and Drug Programs

The Department of Alcohol and Drug Programs oversees a variety of alcohol and drug treatment and prevention programs. The Budget includes \$597.8 million (\$237.8 million General Fund), a net increase of \$5.1 million (\$2.4 million General Fund) above the 2003 Budget Act for substance abuse prevention programs.

### Adjustments for 2004-05:

**Performance Partnership Grants**—The Budget includes an increase of \$260,000 federal funds to collect outcome data as part of the federal government's Performance Partnership funding process.

**Drug Medi-Cal**—An estimated 67,000 individuals will receive substance abuse treatment services in 2004-05. Services provided include perinatal treatment, narcotic treatment, and outpatient drug-free therapy. The Budget includes an increase of \$3.1 million General Fund for caseload and utilization changes, while proposing to maintain rates at current levels.

**Screening, Brief Intervention, Referral and Treatment Program**—The State has received a \$3.5 million federal grant for brief intervention and treatment pilot programs, which can be an effective method for working with casual drug users to prevent future substance abuse. Funding will be allocated to selected counties and outcome data will be reported to the Department.

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## Emergency Medical Services Authority

**Hospital Bioterrorism Preparedness Program**—The Budget proposes that \$6 million in federal grant funds be utilized to support specific anti-bioterrorism activities by the State and its counties. The grant funds have been awarded by the federal Health Resources and Services Administration to the DHS, as part of a larger grant, and will be passed through to the Emergency Medical Services Authority. Specifically, the \$6 million will be used to increase the hospital, community clinic, and Emergency Medical System (EMS) capacity to respond to injuries and illnesses that result from incidents of bioterrorism, develop mutual aid plans to serve areas not currently covered by EMS agencies in the event of

acts of bioterrorism, and enhance the capability of the California Poison Control System to report data suggestive of bioterrorism actions to local and State health departments in a timely manner.

## Office of Statewide Health Planning and Development

**Health Facility Building Plan Approval**—The Facilities Development Division is responsible for overseeing all aspects of general acute care hospital, psychiatric hospital, and multi-story skilled nursing home and intermediate care facility construction in California to ensure the facilities are safe and available to provide care in the event of a major disaster. The Division manages these responsibilities by developing building standards, approving building plans, and observing construction to ensure the facilities meet State and federal standards. A statutory fee is charged to health facilities at the time of plan submission, which is deposited in the Hospital Building Fund, to support the activities of the Division. The Budget provides a total of \$27.6 million and 193 personnel years. To provide timely approval of building plans for the Division and avoid costly construction delays, the Budget reflects the addition of 44 personnel years and \$5.4 million Hospital Building Fund for increased Division workload.

**Healthcare Professionals for Medically Underserved Areas**—In order to provide support to persons in medically underserved areas, the Administration is continuing scholarships and loan repayment grants to students and practicing healthcare professionals who agree to practice in these areas of the State. The Budget provides a total of \$4.1 million for scholarships and loan repayment grants. The Budget includes an additional \$650,000 Registered Nurse Education Fund to increase the scholarship and loan repayment amounts awarded to registered nurses and registered nursing students. In addition, the Administration for the first time is providing support for licensed mental health practitioners of \$206,000 Mental Health Practitioner Education Fund for loan repayment awards, and \$131,000 Vocational Nurse Education Fund for scholarships and loan repayments for vocational nurses and vocational nursing students. All awardees from these programs must agree to serve a minimum of one year in a medically underserved area of California.



## Department of Child Support Services

Chapters 478 and 480, Statutes of 1999, established the DCSS and authorized the implementation of a single, statewide child support system comprised of local child support agencies under the supervision of the new Department. The Budget proposes approximately \$1.3 billion (\$499 million General Fund) and 320 personnel years for this purpose.

**County Administration**—The 2004-05 Budget proposes \$193.3 million General Fund for local agency administrative costs. While this represents a reduction from the amount derived from the methodology prescribed in statute to support local agency costs, it generally provides the same level of funding for local program expenditures that was provided in 2003-04.

**Child Support Collections**—For 2004-05, child support collections are projected to be \$2.4 billion (\$364.5 million General Fund), an increase of \$205 million (\$52.5 million) General Fund above the 2002-03 actual collections of \$2.2 billion (\$312 million General Fund). The 2003-04 projections reflect an increase in the collections of \$11 million General Fund compared to the 2002 May Revision projections, which is attributable to the anticipation of increased child support collections as the result of the Collections Enhancement initiative. In general, collections to reimburse governments for public assistance costs continue to decline as the child support caseload shifts from custodial parents who receive public assistance to those who have never, or no longer receive public assistance.

**Child Support Automation**—Chapter 479, Statutes of 1999, designated the Franchise Tax Board as the agent of the Department for the procurement, development, implementation, and maintenance and operation of the California Child Support Automation System (CCSAS). The State is responsible for developing and implementing the CCSAS and transitioning all counties onto this new system. In June 2003, the State entered into a contract with IBM Global Services to develop and implement the Child Support Enforcement component of the CCSAS. The State expects to have the new system completed by 2008-09.

**County Share of the Alternative Federal Penalty**—As a result of California's delay in implementing a single, statewide-automated



system, the federal government has levied significant federal penalties against the State. In 2003-04, the federal penalty is estimated to be \$195 million. Counties will pay 25 percent of the penalty in 2003-04, which offsets \$48.7 million in General Fund costs. This sharing ratio is consistent with that required for other social service programs. The Administration proposes that counties continue to pay a 25 percent share of the penalty in 2004-05 and future years. The county share of the penalty in 2004-05 would be \$55 million.

**County Share of Child Support Collections**—It is proposed that the county share of child support collections be eliminated, and the dollars remitted as General Fund revenue in lieu of requiring further reductions to the Child Support Program. This will result in additional General Fund revenues of \$39.4 million, which are included in the revenue projections noted above.

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## California Department of Aging

The Budget proposes \$185.3 million (\$33.4 million General Fund) to carry out the Department's programs in 2004-05. This includes the major budget adjustments discussed below.

**Long-Term Care Ombudsman Program**—The Administration has demonstrated its strong support for quality of care provided to nursing home residents by proposing additional funding to expand the Long-Term Care Ombudsman Program. The Budget reflects total funding of \$12.3 million, an increase of \$2.3 million in Federal Medicaid reimbursements. This funding will enable the Long-Term Care Ombudsman Program to enhance the State's presence in approximately 6,400 residential care facilities for the elderly.

**Block Grant**—The Administration proposes to convert State support for Aging programs to a block grant and reduce General Fund support by 5 percent (\$1.7 million General Fund). The block grant is expected to improve the efficiency of administering the various Aging programs that serve the elderly. The block grant will provide more flexibility to utilize grant resources to better match local priorities and needs.

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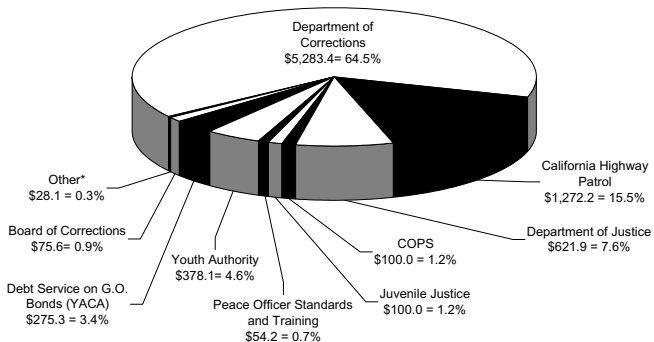
# PUBLIC SAFETY

The 2004-05 Governor's Budget proposes total funding of approximately \$8.2 billion for various programs within the Youth and Adult Correctional Agency, Department of Justice, Commission on Peace Officer Standards and Training, and the California Highway Patrol. The amount proposed is a 7.3 percent decrease over the revised 2003-04 Budget amount. The more significant funding changes for these programs are as follows:

## Secretary for the Youth and Adult Correctional Agency

**Assumption of Auditing and Investigation Functions—**The Budget includes \$630,000 and six personnel years to carry-

**FIGURE PS-1** Proposed Public Safety Expenditures for 2004-05  
All Funds  
(Dollars in Millions)



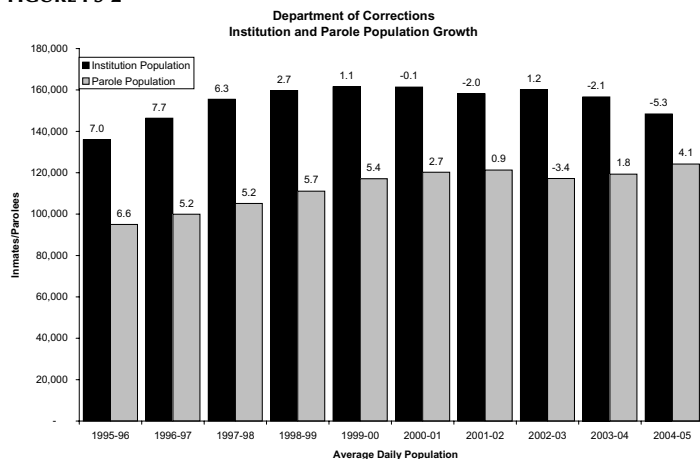
\* Includes the Youth and Adult Correctional Agency, Board of Prison Terms, and the Commission on Correctional Peace Officer Standards and Training.



out oversight functions previously required of the Office of the Inspector General (OIG). The Budget also proposes the elimination of the OIG as part of this proposal.

## Department of Corrections

FIGURE PS-2



This chart has changed from previous years, this chart is displaying average daily population, previous charts used population as of June 30.

**Prison Population**—Prison average daily inmate population is projected to increase from 162,307 in fiscal year 2003-04 to 163,620 in fiscal year 2004-05, an increase of 1,313 inmates, or 0.8 percent. However, these population numbers do not include the effect of new programs included in the 2003 Budget Act, which are projected to reduce the average daily inmate population in 2003-04 by 5,671, and in 2004-05 by 14,748. In fiscal year 2004-05, incarceration and parole services will be provided through 33 institutions, 11 reception centers, 38 camps, and 13 community correctional facilities.

**Parole Population**—The State average daily parole population is projected to decrease from 114,276 in 2003-04 to 111,678 in 2004-05, a decrease of 2,598 parolees, or 2.2 percent. However, these population numbers do not include the effect of new programs included in the 2003 Budget Act, which are projected to

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increase average daily parolee population in 2003-04 by 5,071, and in 2004-05 by 12,546.

**Improving Accountability and Implementing Program Reform—**

The Budget includes a set aside reduction of \$400 million to reflect changes in the correctional system. To achieve this level of savings, the Secretary of the Youth and Adult Correctional Agency is developing a multifaceted reform proposal that is designed to re-evaluate the State's correctional systems, including restoring fiscal control and accountability, assessing parole terms and revocation rates, reviewing and potentially revamping parole programs and supervision, evaluating and recommending the closure of facilities as populations decline or due to the age and condition of facilities, and examining opportunities to improve the operations and reduce costs.

The detailed reform proposal with associated budget reductions will be submitted to the Legislature as part of the May Revision.

**Relief Factor Adjustment—**The Budget contains \$99.5 million to increase the budgeted relief factors for posted positions to allow employees in posted positions the opportunity to receive training, take off accrued time in a timely manner, reduce the liability for excess leave balances, and reduce staff overtime.

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## **Incarceration of Undocumented Felons**

The State of California currently spends approximately \$711.2 million in the Departments of Corrections and Youth Authority related to the incarceration of undocumented persons. The Budget anticipates that the State will receive approximately \$66.2 million in 2003-04 and 2004-05 from the federal government under the State Criminal Alien Assistance Program as a partial reimbursement of these costs.

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## **Board of Corrections**

**Transfer of Office of Criminal Justice Planning Juvenile Justice Grant Programs—**The Budget reflects the transfer of program activities related to Juvenile Justice Grants from the Office of



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Criminal Justice Planning to the Board of Corrections, effective January 1, 2004.

**Board of Corrections to be Fee Based**—A decrease in \$1.7 million General Fund and an increase of \$1.9 million Board of Corrections Administration Fund associated with the Board generally being supported through fees rather than the General Fund.

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## Department of the Youth Authority

**Institution and Parole Population**—The Youth Authority projects an institution population of 3,820 on June 30, 2005, which is a decrease of 235 wards from the anticipated population of 4,055 on June 30, 2004. The parole caseload is projected to be 3,810 by June 30, 2005, which is a decrease of 215 cases from an estimated caseload of 4,025 on June 30, 2004.

**Institution Closures**—The Budget reflects a reduction of \$43.9 million and 354 personnel years due to the closure of the Fred C. Nelles Youth Correctional Facility, a youth conservation camp and additional savings associated with the closure of facilities previously proposed. The closures are necessary to accommodate the continuing decline in ward population.

**Program Restructuring**—The Budget includes a reduction of \$600,000 due a proposed restructuring of the Department's operations, which include, a decrease in the age of Youth Authority's jurisdiction from 25 to 22 years, the implementation of juvenile sentencing reforms, and the implementation of a casework staffing model.

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## Department of Justice

The Budget includes total expenditures of \$621.9 million for the Department of Justice. This amount includes an unallocated reduction of \$3 million General Fund, which will not affect the ability of the Department to fulfill its law enforcement mission. In addition, the Budget proposes the following augmentations for 2004-05:

**California Witness Protection Program**—An augmentation of \$3 million Restitution Fund and a reduction of \$3 million General

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Fund to continue the California Witness Protection Program. Due to insufficient Restitution Fund resources in 2003-04, funding to continue the program was provided by the General Fund. The Restitution Fund is now able to support the program.

**California Methamphetamine Strategy Program (CALMS)**—\$2.4 million federal funds is proposed to utilize grants provided by the U.S. Department of Justice. This funding will provide electronic surveillance equipment for CALMS enforcement.

**Automated Criminal History System Redesign**—\$2 million Fingerprint Fee Account and 2.8 personnel years to design, build, and implement a redesigned Automated Criminal History System.

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# RESOURCES/ CALIFORNIA ENVIRONMENTAL PROTECTION AGENCY

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## Resources

- The Governor's Budget continues to fund activities within the Department of Fish and Game, Department of Conservation, and Department of Forestry and Fire Protection to enforce existing environmental protection laws.
- The Administration remains committed to the State's responsibility to "Keep Tahoe Blue."
- California's participation in the CALFED Bay-Delta Program will continue to exceed the federal commitment.
- The Governor's Budget proposes to increase State Park fees, which will allow for continued operation of all facilities and continue to bolster the local economies in which the parks reside.
- The Governor's Budget proposes to reduce the California Conservation Corps by \$12.8 million, which will result in a 14 percent reduction in the number of corps members served. The ongoing program will continue to provide vital resource protection services and train a full time equivalent of 1,200 corps members.



## California Environmental Protection Agency

- The Governor's Budget proposes \$52.3 million from the Electronic Waste Recovery and Recycling Account for the California Integrated Waste Management Board to implement the Electronic Waste Recycling Program established by Chapter 526, Statutes of 2003, to reduce and reuse the State's huge stockpile of electronic devices such as computer monitors and televisions.
- The Governor's Budget includes \$3 million to continue equipment upgrades for the measurement and monitoring of small particulate matter (PM 2.5).
- The Governor's Budget includes \$1.5 million (funded by fees on the manufacture and use of perchloroethylene) for the new Non-Toxic Dry Cleaning Incentive Grant Program established by Chapter 821, Statutes of 2003, to aid dry cleaners in transition to nontoxic and non-smog-producing technologies.
- The Governor's Budget proposes \$226,000 to implement a Mobile Hazardous Materials Laboratory to respond quickly and effectively to a wide variety of emergencies around the State.

# **BUSINESS, TRANSPORTATION, AND HOUSING**

**T**he Governor's Budget proposes total expenditures of \$9.6 billion in 2004-05 for roads, highways, mass transit and intercity rail, vehicle licensing and registration, and highway law enforcement.

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## **Department of Transportation**

California transportation supports the mobility of goods and people, creates jobs directly and throughout the economy, and leverages local and federal resources for critical mobility and air quality projects through its borders, ports, rail, and highway corridors. The Budget includes \$7.4 billion in expenditures by the Department of Transportation (Caltrans) and 20,585 personnel years.

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## **Transportation Resources**

Transportation funding alternatives must be identified to assist in economic growth, improve the mobility of people and goods in California and throughout the nation, and improve our quality of life. The Administration will work with the transportation stakeholder, business, and labor communities in a full review of opportunities to fully leverage State and federal transportation resources.



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## **Federal Transportation Reauthorization**

The Administration will take an active role with California transportation stakeholders in seeking responsible overall funding levels from Washington, DC, and a share of those programs that reflects California's critical role in the national economy and global trading system.

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## **Grant Anticipation Revenue Vehicle**

The Administration endorses the use of Grant Anticipation Revenue Vehicle (GARVEE) financing to infuse funds into transportation in the near term, especially during these times of fiscal constraint. The Budget includes \$800 million from federal GARVEE for allocation by the California Transportation Commission. GARVEEs are debt instruments where future federal-aid highway funds are pledged to meet debt service requirements.

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## **High Speed Rail Authority**

Notwithstanding the potential merit of providing high speed rail as an alternative mode of transportation, budget trailer bill is proposed to repeal Chapter 697, Statutes of 2002, which places a \$9.95 billion general obligation bond measure before voters in 2004 (the Safe, Reliable, High-Speed Passenger Train Bond Act for the 21st Century). Given the State's current fiscal situation, it would be premature for the State to move forward with additional General Fund debt of this magnitude at this time. The needs for funding high speed rail will be reviewed as part of an overall discussion of transportation resources.

# JUDICIAL BRANCH

The 2004-05 Governor's Budget includes a total of \$2.9 billion (\$1.6 billion General Fund) for the Judicial Branch:

(Dollars in Millions)

	<b>Total</b>	<b>General Fund</b>
State Judiciary	\$374	\$303
State Trial Court Funding	2,218	1,116
Commission on Judicial Performance	4	4
Judges' Retirement Costs	276	147

For the Judiciary, the 2004-05 Governor's Budget reflects total expenditures of \$374 million. Specifically, the Judiciary's budget includes the following adjustments:

- An unallocated General Fund reduction of \$9.8 million in 2004-05.
- An increase of \$235,000, of which \$180,000 is one-time, from the Court Interpreter Fund to address increased costs of certification activities.

For the Commission on Judicial Performance, the 2004-05 Governor's Budget reflects total expenditures of \$3.9 million, which reflects continuation of the current level of funding.



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For State Trial Court Funding, the Budget reflects total expenditures of \$2.2 billion. For the trial courts, the Budget includes the following adjustments:

- An unallocated General Fund reduction of \$59 million in 2004-05.
- An increase of \$2.6 million General Fund associated with a statutory requirement to reimburse trial courts for costs related to hearings of trials for crimes committed in a State prison. An associated reduction was made in the California Department of Corrections budget.

In addition, the Administration would support the Judicial Branch in efforts to restructure court operations to provide greater State-level participation in local court labor negotiations, the provision of court security, and employees benefits to allow courts to have more control over major cost drivers, improve consistency in how funding is spent in courts throughout the state, and ensure that court services are provided at a consistent and adequate level.

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# GENERAL GOVERNMENT

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## Department of General Services

The 2004-05 Governor's Budget includes total expenditures of \$874.5 million (\$3 million General Fund) for the Department of General Services. The Governor's Budget proposes the following for 2004-05:

**Asset Planning and Enhancement**—The Budget includes \$3 million Property Acquisition Law Money Account to fund staff and consultant services to assist in the marketing and sale of State surplus properties. Properties affected by budget reductions in other program areas, including the closure of correctional facilities administered by the Youth and Adult Correctional Agency, will be evaluated with the goal of ensuring maximum General Fund revenue.

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## Department of Fair Employment and Housing

**Federal Funds Augmentation**—The Governor's Budget includes an augmentation of \$1 million federal funds to properly align the Department's federal expenditure authority with its annual federal fund receipts, and to address a structural shortfall in the Department's operating budget.



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## Department of Consumer Affairs

**Athletic Commission Fund Shift**—The Governor's Budget includes a reduction of \$619,000 General Fund and an increase of \$709,000 Athletic Commission Fund to convert support for the activities of the Athletic Commission to special fund fees. The Commission has always been fee-supported, however, these fees were deposited into the General Fund in support of the Commission. This change will bring the structure of the Commission's budget into conformity with those of the other professional licensing entities under the Department of Consumer Affairs.

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## Office of Emergency Services

In times of major emergency or disaster in California, the Office of Emergency Services (OES) coordinates emergency response activities to save lives, reduce property loss, and expedite recovery. The Governor's Budget proposes \$905.4 million and 447 personnel years for the OES.

**Southern California Wildfires**—The Governor's Budget proposes \$60 million in 2003-04 and \$40 million in 2004-05 for recovery from the wildfires in Southern California.

**Homeland Security**—The Governor's Budget proposes \$160.3 million federal funds for 2003-04 and \$4.6 million federal funds for 2004-05 to provide training, equipment, and planning for the purposes of homeland security. A spring budget change proposal will be proposed that will identify the federal fiscal year 2004 funds that will be available for additional homeland security funding.

**Office of Criminal Justice Planning Transfer**—The Governor's Budget reflects the transfer of program activities related to Victims Services and Public Safety from the Office of Criminal Justice Planning to OES, effective January 1, 2004. We note that Control Section 25.00 in the Budget Act of 2003 required a Governor's Reorganization Plan (GRP) to be submitted March 1, 2004. The Administration now plans on submitting the required GRP in May 2004, as part of its statewide proposal to restructure state government.



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## California Science Center

**Science Center Elementary School and Center for Science Learning**—The Governor's Budget proposes \$2.4 million (\$1.4 million General Fund) for the first year of operation of the newly-completed Science Center Elementary School, to be operated by Los Angeles Unified School District, and the Center for Science Learning.

**Parking Structure**—The Governor's Budget includes \$260,000 Exposition Park Improvement Fund for annual operational costs of the new parking structure in Exposition Park.

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## California Victim Compensation and Government Claims Board

The 2004-05 Governor's Budget proposes \$141.3 million other funds for the Victim Compensation and Government Claims Board.

**Government Claims Program**—The Governor's Budget proposes to shift costs associated with the Government Claims Program to reimbursements, for General Fund savings of \$809,000 beginning in 2004-05. Under this proposal, filers of civil claims against the State would pay a filing fee, which would be refunded upon approval and payment of the claim. This proposal would also require charities that benefit from the California State Employees Charitable Campaign to support the full cost of the certification program, rather than the General Fund.

**Victim Compensation Program**—The Governor's Budget includes \$140.4 million Restitution Fund and federal funds for administration of the Victim Compensation Program. The Governor's Budget funds all program costs, despite past concerns about Restitution Fund shortfalls, and allows for a prudent reserve balance.

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## Military Department

The Military Department is responsible for the command, leadership, and management of the California Army and Air National Guard, whose purpose is to provide military service support to California, as well as the nation. These services are provided



through 118 armories, 10 air bases, and 3 army bases located throughout California. The Governor's Budget proposes \$93.8 million and 654 personnel years for the Department. The Department also receives an additional \$571.3 million in federal funds that are not deposited in the State treasury.

**Homeland Security**—\$8.8 million federal funds and five personnel years in 2003-04 and \$2.1 million federal funds and seven personnel years in 2004-05 to provide a homeland security augmentation for equipment, training, exercises, and infrastructure.

**Armory Project Managers**—\$360,000 federal funds and three personnel years to provide additional project managers to operate the Military Construction program.

**Fresno Firefighter Positions**—\$298,000 federal funds and four personnel years in 2003-04 and \$383,000 federal funds and five personnel years in the 2004-05 to provide additional firefighter positions at the Fresno Air National Guard Base.

**Joint Training and Experimentation Program Manager Position**—\$113,000 federal funds and one personnel year in 2003-04 and \$133,000 federal funds and one personnel year in 2004-05 to provide one State Active Duty position to manage the Joint Training and Experimentation Program.

**Family Assistance Officer for the "Operation Ready" Families Program**—\$101,000 federal funds and one personnel year in 2003-04 and \$129,000 federal funds and one personnel year in 2004-05 to provide a Family Assistance Officer of the "Operation Ready" Families Program.

**Bridge Guarding**—\$5.5 million General Fund in 2003-04 associated with the California National Guard providing 24-hour, seven-days-a-week coverage at the Golden Gate Bridge.

**Youth Program Reductions**—The Governor's Budget proposes a reduction of \$1.4 million General Fund and ten personnel years associated with reductions to the Starbase Program, Challenge Program, California Cadet Corps, and the Oakland Military Institute.

## CAPITAL OUTLAY

**T**he Governor's Budget includes \$1.55 billion for the capital outlay program, not including funding for transportation, K-12 schools, and State conservancies. The General Fund contributes \$32.6 million of the total; \$145.2 million is proposed from lease-revenue bonds; and \$1.3 billion is from higher education bonds and other general obligation (GO) bonds.

The Governor's Budget includes:

- \$1.3 billion from Proposition 47 and Proposition 55 funds (March 2004 Ballot) for numerous construction projects within the University of California, the Hastings College of the Law, the California State University, and the California Community Colleges that help meet the needs of increasing enrollment, replace aging facilities, and renovate existing buildings to address fire, life, and safety, as well as seismic concerns.
- \$69.9 million in lease-revenue bonds for the Department of Education, State Special Schools to replace a dormitory and campus chiller system to address critical infrastructure needs at the California School for the Deaf in Riverside.
- \$22.6 million from various funds for the Department of Parks and Recreation for projects that address critical safety issues, Off-Highway Vehicle Park improvement projects, and funding for various acquisitions.
- \$18.8 million General Fund for the Department of Corrections for capital outlay projects to address critical infrastructure deficiencies, security concerns, and health and safety issues, that include cell security lighting, arsenic removal from potable water, and space to treat hemodialysis patients.



- \$12.8 million in lease-revenue bonds and \$6.4 million from the State Highway Account for the Department of Food and Agriculture to complete the relocation of an Agriculture Inspection Station in Truckee. This relocation is part of the California Department of Transportations' Master Plan to address traffic concerns and highway improvements in Truckee.
- \$8.8 million from the Motor Vehicle Account, State Highway Account, and the Vehicle License Fee Account to complete continuing projects for the Department of Motor vehicles as part of the renovation of its headquarters.
- \$5 million General Fund and \$6.4 million in matching federal funds for the construction of a new armory in Bakersfield to accommodate two new transportation units.
- \$4.1 million General Fund for the Department of Forestry and Fire Protection, consisting of \$1.8 million to acquire long-term property rights that are necessary to complete six projects using previously authorized lease-revenue bonds, \$1.8 million to convert a high priority lease-revenue bond project to General Fund due to issues preventing debt financing, and \$500,000 for the renovation of a critical emergency communications facility.

# CALIFORNIA'S FAIR SHARE OF FEDERAL FUNDS

California has increasingly become a donor State, meaning that California taxpayers contribute far more to the federal budget than California receives in federal services. Actions at the federal level have resulted in the State paying for increased costs or expansion of federal-State-local programs, as well as for significant costs for new programs. In recent years, the tax payments that Californians have made to the federal government have significantly exceeded the amount of federal expenditures made in the State. Although there are differing estimates of the magnitude of the gap, the non-partisan California Institute for Federal Policy Research estimates the figure for federal fiscal year 2002 at \$58 billion. Additionally, the federal government is increasingly assessing sanctions against California for not meeting rigid administrative requirements. As such, the Governor's Budget assumes that California will be successful in securing a minimum of \$350 million to offset General Fund costs in the 2004-05 fiscal year.

Below are various programmatic examples of inequities in federal funding policies:

- Homeland Security
- Transportation
- Medi-Cal
- Incarceration of Undocumented Felons
- Child Care Funds
- Education Tax Credit

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## STATE-LOCAL ASSISTANCE

**B**oth the U.S. and California economies slowed in 2001. Due to its dependence on the personal income tax with its highly volatile capital gains component, the State faces significant fiscal challenges. However, local revenue sources such as sales and property taxes are less volatile. Consequently, cities and counties have not experienced such drastic swings in revenues as has the State.

Due to the current State fiscal environment, reductions were required to local government funding in a number of areas. However, the Governor's Budget continues the Administration's efforts to support high priority programs of mutual concern to the State and local governments, such as public safety, health and human services, housing, transportation, and resources. The funding provided for these programs totals nearly \$6.7 billion.

In addition, the Budget includes full reimbursement to local governments for the vehicle license fee offset program, totaling approximately \$2.7 billion in 2003-04 and \$4.1 billion for 2004-05. Important to note, however, is that in 2003-04, local governments' vehicle license fee revenues were reduced by \$1.3 billion due to lag time necessary to implement higher fees when the offset was eliminated on June 20, 2003. Chapter 231, Statutes of 2003, provided that this "gap" in funding would be repaid to local governments in 2006-07. Due to the State's current fiscal environment, the Budget proposes a continuation of the 2003-04 gap level of reduction (\$1.3 billion) to local governments in the form of an increased Educational Revenue Augmentation Fund (ERAF) shift beginning in 2004-05. Local governments would shift approximately \$1.3 billion of property tax revenues to the ERAF in order to decrease the State's General Fund Proposition 98 obligation.

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# STATEWIDE ISSUES

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## A Fundamental Review of State Government

California government is filled with skilled and dedicated men and women, but without focused leadership State agencies have been left to drift instead of serving the public most effectively. The California Performance Review will be a comprehensive examination of what government does and how it is done. Led by people that understand the problems government faces firsthand, the Performance Review will transform state government and energize the bureaucracy so that they provide the best services to the public in the most efficient way.

The initiative has four major components:

1. **Executive Branch Reorganization**
2. **Program Performance Assessment and Budgeting**
3. **Improved Services and Productivity**
4. **Acquisition Reform**

The leadership and energy to make these reforms happen can be found both inside and outside of government. There are a handful of people in America that possess the experience with a performance review of this magnitude and they have agreed to be a part of the outside team that will train and manage 125–150 senior career managers, borrowed from within the state government bureaucracy, to conduct this review.



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The Administration will also form the California Performance Review Commission, which may consist of legislators, business men and women, representatives from local government, other Constitutional Officers, and other interested parties. The Commission will provide counsel, advice, and conduct public hearings to get input from the general public on the current performance of government operations and ways to improve that performance.

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## **Review of Business Practices of Charging Encumbrances**

Executive Order S-4-03 instructed departments to disencumber non-essential contracts and purchase agreements funded by the General Fund where the goods and services have not been received. At this time, it is estimated that \$50 million of one-time General Fund savings will be achieved. In addition to canceling current encumbrances, the Department of Finance will convene a work group of selected departments and other control agencies in January to review current practice, statutes, and regulations to determine the timing and appropriateness of charging an encumbrance.

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## **Pension Reform Package**

In the fiscal environment for the foreseeable future, the State can no longer afford the current retirement program without a reduction in benefits or an increase in employees' contributions toward the benefits. Beginning in 2004-05, the State will be pursuing two strategies to control the State's costs for pension benefits. For existing State employees, the State will be seeking to increase employees' annual retirement contributions by 1 percent of their gross pay rather than change retirement benefits; in most cases this increase will be from 5 percent to 6 percent. For most new employees who have had no expectation of a specific retirement formulae, the State will be pursuing legislation to return to the pre-SB 400 formulae.

In order to realize immediate benefits from these reforms, the State will be seeking new pension obligation bonds to pay a portion of the pension contributions until the effect of returning to the

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pre-SB 400 benefit levels is sufficiently recognized in CalPERS' actuarial projections.

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## **Health and Dental Benefits for Retired Annuitants**

The Budget proposes an increase of \$195.3 million in 2004-05 based on both premium and enrollment growth. The Administration will be examining ways to reduce future health care benefit costs.

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## **State Teachers' Retirement System**

The Budget proposes to increase funding for Benefits Funding by \$21 million as a result of an increase in teacher payroll. In addition, the Budget proposes to increase funding for the Supplemental Benefit Maintenance Account by \$526.1 million, \$26.1 million as a result of an increase in teacher payroll and \$500 million to reflect that the 2003-04 \$500 million reduction was a one-time action.

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## **Contracting For Services**

In November 2000 the voters of California recognized the imprudence of the restrictions on contracting for architectural and engineering services when they added Article XXII to the Constitution. The Administration will be pursuing a new Constitutional amendment to expand Article XXII to permit the State to contract with non-State entities for ministerial functions whenever doing so will reduce costs, improve efficiency, or improve services.

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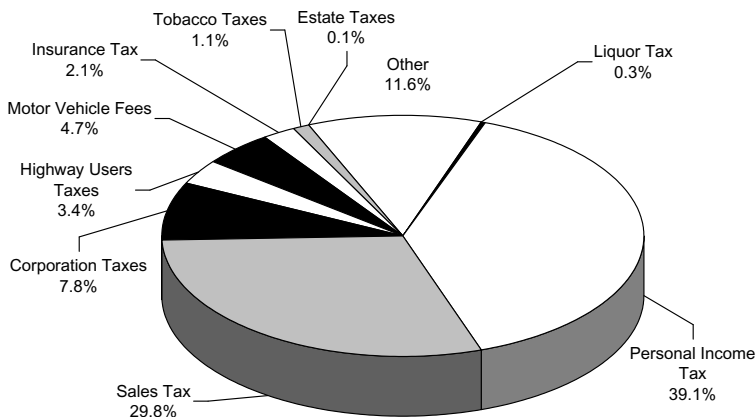
# SUMMARY CHARTS



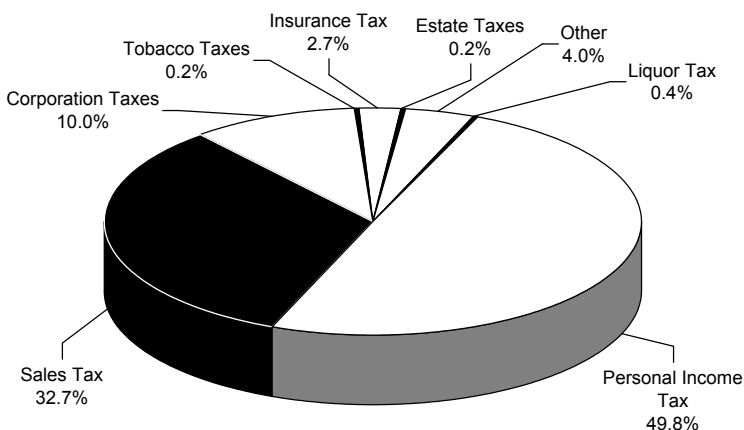
## Revenues

### 2004-05 Fiscal Year

**2004-05  
Total Revenues and Transfers**

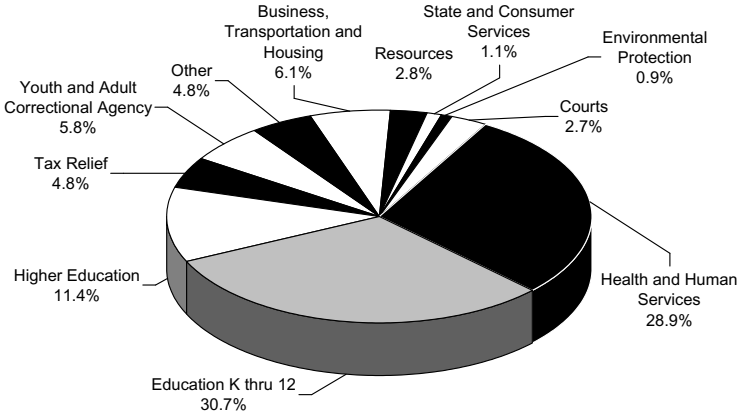


**2004-05  
General Fund Revenues and Transfers**

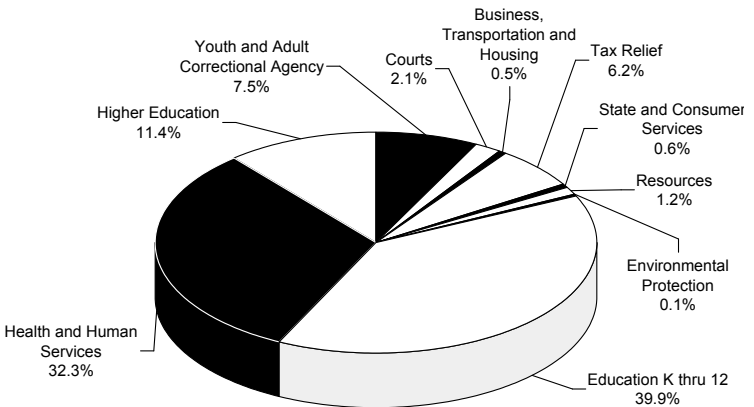


## Expenditures 2004-05 Fiscal Year

**2004-05  
Total Expenditures  
(Including Selected Bond Funds)**



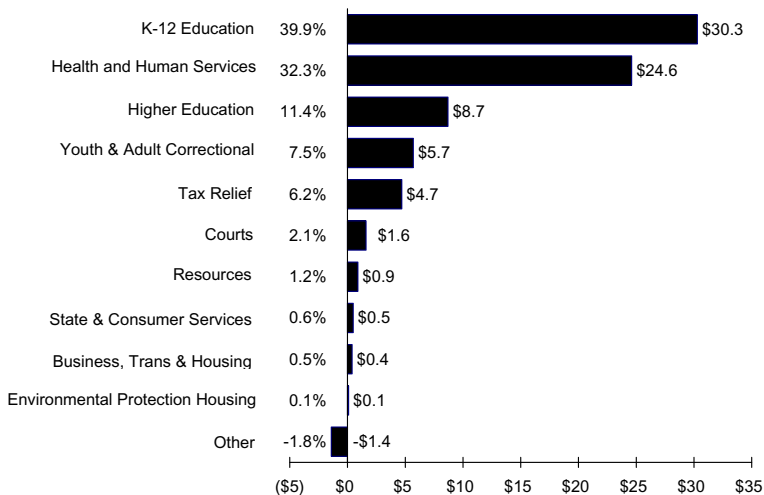
**2004-05  
General Fund Expenditures**



Percentages do not total 100% due to the "Other" category being ~1.8%.



### 2004-05 General Fund Expenditures (Dollars in Billions)





**2004-05 Expenditures By Fund**  
(Dollars in Millions)

<b>Function</b>	<b>General Fund</b>	<b>Special Funds</b>	<b>Bond Funds</b>	<b>Total</b>
Education (K-12)	\$30,317	\$59	\$36	\$30,412
Health and Human Services	24,600	4,068	2	28,670
Higher Education	8,694	1,200	1,567	11,461
Business, Transportation and Housing	375	5,528	148	6,051
Courts	1,569	1,121	--	2,690
Tax Relief	4,730	--	--	4,730
Local Government Subventions	260	2,311	--	2,571
Youth and Adult Corrections	5,732	4	--	5,736
Resources	939	1,685	125	2,749
Environmental Protection	70	764	12	846
State and Consumer Services	478	559	13	1,050
Other	-1,702	3,845	35	2,178
<b>Total</b>	<b>\$76,062</b>	<b>\$21,144</b>	<b>\$1,938</b>	<b>\$99,144</b>



## 2004-05 Revenue Sources

(Dollars in Millions)

	General <u>Fund</u>	Special <u>Funds</u>
Personal Income Tax	\$38,043	--
Sales Tax	25,022	\$3,952
Corporation Taxes	7,609	--
Highway Users Taxes	--	3,322
Motor Vehicle Fees	16	4,563
Insurance Tax	2,078	--
Estate Taxes	136	--
Liquor Tax	294	--
Tobacco Taxes	115	917
Other	<u>3,094</u>	<u>8,049</u>
<b>Total</b>	<b>\$76,407</b>	<b>\$20,803</b>

## General Fund Expenditures in Major Program Areas

	2003-04	2004-05	Difference
Legislative, Judicial, and Executive	\$2,528	\$2,616	\$88
State and Consumer Services	471	478	7
Business, Transportation, and Housing	518	375	-143
Resources	985	939	-46
Environmental Protection	91	70	-21
Health and Human Services	22,789	24,600	1,811
Youth and Adult Correctional	5,326	5,732	406
K-14 Education	31,418	33,152	1,734
Debt Service Savings (ERAF)	0	-1,256	-1,256
Higher Education	6,352	6,058	-294
Labor and Workforce Development	113	86	-27
Vehicle License Fee Backfill	2,703	4,062	1,359
STRS Contribution	510	1,057	547
General Government	1,212	1,105	-107
Use of Deficit Recovery Fund	<u>3,012</u>	<u>-3,012</u>	<u>-6,024</u>
<b>Totals</b>	<b>\$78,028</b>	<b>\$76,062</b>	<b>-\$1,966</b>

**2004-05 Governor's Budget**  
**General Fund**  
**Budget Summary**  
(Dollars in Millions)

	<u>2002-03</u>	<u>2003-04</u>	<u>2004-05</u>
Prior Year Balance	-\$1,474	\$1,608	\$1,219
Revenues and Transfers	\$71,322	\$74,627	\$76,407
Bond Proceeds	<u>\$9,242</u>	<u>\$3,012</u>	<u>--</u>
Total Revenues	\$80,564	\$77,639	\$76,407
<b>Total Resources Available</b>	<b>\$79,090</b>	<b>\$79,247</b>	<b>\$77,626</b>
Expenditures	\$77,482	\$75,016	\$79,074
Transfer to and Use from Deficit Recovery Fund		\$3,012	-\$3,012
Total Expenditures	<u>\$77,482</u>	<u>\$78,028</u>	<u>\$76,062</u>
<b>Fund Balance</b>	<b>\$1,608</b>	<b>\$1,219</b>	<b>\$1,564</b>
<b>Budget Reserves:</b>			
Reserve for Liquidation of Encumbrances	\$929	\$929	\$929
Special Fund for Economic Uncertainties	\$679	\$290	\$635
Special Fund for Economic Uncertainties without Solutions	-\$9,242	-\$12,254	-\$26,273
Operating Deficit without Solutions	-\$6,839	-\$3,012	-\$14,019



### General Fund Solutions by Category

(Dollars in Thousands)

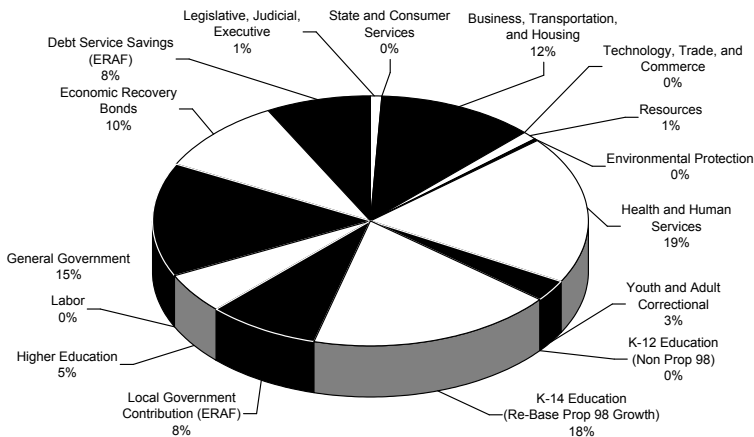
<u>Solution</u>	<u>2002-03</u>	<u>2003-04</u>	<u>2004-05</u>	<u>Total</u>	<u>% of Total</u>
Spending Reductions	-\$161,784	-\$1,158,011	-\$4,618,885	-\$5,938,680	36.6%
Fund Shifts	0	-41,100	-1,043,579	-1,084,679	6.7%
Cost Avoidance:					
Suspend Prop 42 Transfer	0	0	-947,186	-947,186	5.8%
Re-Base Proposition 98 Growth	-517,836	-448,419	-1,910,287	-2,876,542	17.7%
Other	0	-609	-106,458	-107,067	0.7%
Economic Recovery Bonds	1,433,400	0	-3,012,000	-1,578,600	9.7%
Debt Service Savings	0	0	-1,256,000	-1,256,000	7.7%
Transfers/Other Revenue	0	-771,077	-475,561	-1,246,638	7.7%
Loans/Borrowing	0	-203,800	-45,000	-248,800	1.5%
Pension Reform Package	0	0	-949,747	-949,747	5.9%
<b>Totals</b>	<b>\$753,780</b>	<b>-\$2,623,016</b>	<b>-\$14,364,703</b>	<b>-\$16,233,939</b>	<b>100.0%</b>

## General Fund Solutions by Agency (Dollars in Thousands)

<u>Agency</u>	<u>2002-03</u>	<u>2003-04</u>	<u>2004-05</u>	<u>Total</u>	<u>% of Total</u>
Legislative, Judicial, Executive	\$0	\$0	-\$113,961	-\$113,961	0.7%
State and Consumer Services	0	-18,550	-14,941	-33,491	0.2%
Business, Transportation, and Housing	0	-886,800	-999,250	-1,886,050	11.6%
Technology, Trade, and Commerce	0	-6,600	0	-6,600	0.0%
Resources	-132,200	-8,700	-47,269	-188,169	1.2%
Environmental Protection	0	0	-9,338	-9,338	0.1%
Health and Human Services:					
Medi-Cal	-8,184	-229,994	-880,521	-1,118,699	6.9%
Public Health	0	-4,444	-9,749	-14,193	0.1%
Managed Risk Medical Insurance Board	-2,290	0	-32,109	-34,399	0.2%
CalWORKs	0	0	-787,360	-787,360	4.9%
SSI/SSP	0	0	-134,675	-134,675	0.8%
In-Home Supportive Services	0	-129,163	-126,539	-255,702	1.6%
Developmental Services	-2,709	0	-155,368	-158,077	1.0%
Mental Health	-1,408	-361	-37,562	-39,331	0.2%
Other Health and Human Services	-14,993	-49,928	-536,161	-601,082	3.7%
Youth and Adult Correctional	0	0	-438,017	-438,017	2.7%
K-12 Education (Non Prop 98)	0	-609	0	-609	0.0%
K-14 Education (Re-Base P98 Growth)	-517,836	-448,419	-2,003,996	-2,970,251	18.3%
Local Government Contribution (ERAF)	0	0	-1,336,000	-1,336,000	8.2%
Higher Education	0	-157,709	-728,782	-886,491	5.5%
Labor Agency	0	-808	-808	-1,616	0.0%
General Government	0	-680,931	-1,704,297	-2,385,228	14.7%
Economic Recovery Bonds	1,433,400	0	-3,012,000	-1,578,600	9.7%
Debt Service Savings (ERAF)	0	0	-1,256,000	-1,256,000	7.7%
<b>Totals</b>	<b>\$753,780</b>	<b>-\$2,623,016</b>	<b>-\$14,364,703</b>	<b>-\$16,233,939</b>	<b>100.0%</b>



## Solutions By Agency



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### California's Budget on the Internet

*This document is also available on the Internet at the California Department of Finance website—[www.dof.ca.gov](http://www.dof.ca.gov)*

